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THE NEW YORK CERTIFIED PUBLIC ACCOUNTANT

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Looking Ahead

By WILLIAM R. DONALDSON, C.P.A., President-Elect

WHAT I have to say tonight really should be reported to you by Henry Horne himself, because the plans for the immediate future of the Society have been developed during his administration, and it is he rather than I who should be telling you of them. However, he asked me to take over this assignment, stating, as he put it in his usual modest way, that the carrying out of these plans is the task of the incoming administration and it would be better, therefore, for me to talk of them and to answer your questions.

There are many forward-looking additions to and extensions of its services that the Society should undertake. The time is ripe, and has been ripe, but the problems and limitations of our wartime economy and the tremendous pressure on committee members who must contribute their time and efforts to make the Society's activities effective and successful have forced deferment until the way is propitious.

WILLIAM R. DONALDSON, C.P.A., President-Elect, has been a member of the Society since 1922 and up to the present time has served as Director, Secretary and Vice-President and held chairmanship of important committees. He served as Deputy Comptroller of the City of New York from 1933 to 1935. He is certified also in Pennsylvania and Connecticut and is a member of the New York Bar, the National Association of Cost Accountants, and the American Institute of Accountants.

At our meeting last month I pointed out that the Society's membership has reached nearly 5,000 and that, strikingly, most of this membership has been acquired during the last seven or eight years. This means that the Society is composed dominantly of young men recently entered into the profession. This is proof of what you have heard so frequently: that ours is a young profession which has progressed and expanded at a phenomenal rate both in influence and in numbers; and the end of the war will doubtless see a great many more men and women seek entrance into our ranks.

It is the Society's obligation—now that we have laid a firm foundation of membership and, equally important and fortunate, in financial ability—to increase the activities of the Society in three distinct, broad

Presented at a meeting of the New York State Society of Certified Public Accountants, May 14, 1945.

fields, with special emphasis toward the wishes and needs of the younger members. These fields, as I see them, are:

(1) To stimulate and make possible a higher level of technical knowledge, information and skill in our members.

(2) To bind the members closer together in their common calling so that they will know one another better and work more cooperatively, harmoniously and helpfully in professional solidarity.

(3) To convey to the public, through various avenues of information, the importance and the great usefulness and value of the services of the C.P.A., the variety of problems in which he can be of assistance and the high order of training, skill and experience which he brings to his client.

Within the first field is the area of our technical meetings, (both our regular meetings and our special meetings), our monthly magazine and the work of our many technical committees. The busy war years brought a halt in the progress being made here, because it was unfair, when they were so hard-pressed by demands of clients, to ask the members of the technical committees to give time and effort to organizing and running meetings and to put in the many hours of preparation necessary to make them of the high quality we want them to be; and also when the attendance at such meetings would perhaps be small, because many members wishing to attend would be prevented from doing so for the same reasons of pressure.

Before the war we made great headway with frequent meetings at the Engineering Societies Building covering a wide variety of subjects, and those meetings, as you will remember, were well and enthusiastically attended. This past year, at Simon Loeb's insistence, we tried out the series on Federal taxes, which proved a great success both in attendance and in quality of subject-matter, and many members have requested this be made a regular annual thing. This tax series, probably expanded, will be carried on again this year.

A few other special meetings were held which also showed good attendance and were followed by comments by many members that we should hold more of them.

Now I going to propose that every one of our technical committees hold at least one open meeting this coming year. While I appreciate the war is only half over and we shall all be busy with problems of reconversion, and that it is still somewhat unfair to ask members to give much time to preparing material, my thought is, to make it practicable, feasible and simple, that most of these meetings can be of a different type than the formally-organized ones that we have had in the past. Out of the type of meeting now proposed, with its smaller attendance, its intimacy, its informality, we can give the members not only excellent technical information but there will begin to grow what, to me, is the greatest need, internally, of our profession here in this big city of ours—that is, a wider acquaintanceship within the profession and more particularly the younger men getting to know the older men and thus finding out that the older men are approachable, friendly, and want to help the younger practitioner.

This plan for such meetings is as follows: In September we would schedule, through the fiscal year, at least one meeting for each technical committee, to be held at the Society's office where, in the large room, an attendance of 65 can be comfortably accommodated. The technical com-

mittee members would not be asked to devote valuable time to special preparation but merely to be on hand to lead discussion and answer questions on these phases of principle and practice which are peculiar to, or represent, controversial areas within that special technical field.

Now these meetings should be most informal and free for all discussions. Because of the limitation to an attendance of 65, admission cards must be requested in advance, and notices of the various meetings would be mailed out twice a month. If considerable more requests should be received for some of the meetings than the limit, then another meeting, of the Committee can be scheduled to be held probably within a month and the disappointed members advised of the situation and sent admission cards to the second meeting.

This may sound like an ambitious program, but when analyzed it is simple and inexpensive, and places no undue burden on the committee members, for we have the room available at the Society's offices and, without needing to prepare, the committee members would have to give up only one or two nights during the year to this professional service to their fellow-members who would like to meet with them informally to talk over with them the problems and peculiarities of that special technical field. I would consider such a meeting well worth while and successful, and accomplishing its purpose, if only ten members came out to meet with the committee.

A question in my mind is, what is the best time for these meetings?: 7:30 to 9:30, or should we try to hold some of them in the afternoon from 4:00 to 6:00, or perhaps Saturday afternoons? We would like to hear your views on this point so that when meetings are to be scheduled we will know the times most agreeable and convenient.

Next, let us speak of our monthly publication. Wartime paper restrictions have, of course, cut down its size and contents, as you probably understand. The Publications Committee, under Dr. Hugh O'Reilly's chairmanship, has kept up the high quality and practical, day-to-day usefulness of the articles published and, next to the Journal of Accountancy, it is the leading accounting periodical in the country. We have many subscriptions from out of the State and from non-members, and the magazine goes into many public libraries, and to the libraries of every college and university in the country whose courses qualify for credit under our New York C.P.A. laws. We should build up the magazine and enlarge it; we should develop editorial viewpoint and comment, not only in relation to our own professional area but also lift up our professional attitude to, and express it on, many areas of public discussion and interest, as, for example, taxes, finance, business economics, Federal and State legislation, etc.

It is amazing what fine work has been done with the magazine on a purely voluntary basis by the Committee on Publications. We have no C.P.A. on our paid staff to clear technical material and to do the difficult job of editing and rewriting. We need and should have on the staff a highly competent accounting and auditing technician and writer to work on the publication and to build it up along these lines. We are looking for him and we hope we can find him very soon. Further, such a technical staff-man is essential to guide and coordinate the increased activity and more frequent meetings proposed for the many technical committees.

Your Board of Directors has al-

ready approved the printing and distribution to the members of all the Accounting Releases of the Securities and Exchange Commission, in handy form as you now receive the Research Bulletins of the American Institute of Accountants—and these will be kept current. The paper situation has delayed the distribution and, as soon as can be done, you will have them in the mail.

In the second broad field I mentioned—that is, getting members better acquainted with one another and cementing professional solidarity—much progress will be made by means of the intimate and smaller technical committee meetings. Another idea the Board has considered, but necessarily has had to defer acting on until the war ends, is a project for holding a series of a dozen or more small dinners, at each of which the host would be a well-known, older, prominent and successful practitioner. Limited to, say, fifteen or twenty persons and held in a private dining room in some club or hotel, with the dinner price moderate, the purpose of such a dinner would be for the younger members to meet, socially and intimately, with the host. Furthermore, in the friendliness and informality of such a dinner, members would become better acquainted with their fellow members seated around the table. Discussion at these dinners would be led by the host and directed toward any phase of professional practice and activity the members present indicated the desire to discuss.

In the third field—that of public information—much lies ahead of us and much can be done. We must throw off some of the shackles of ultra-conservatism, stir our imagination and have the skilled, full-time help of a public relations man of broad experience. We have that man now in Ed Gleason, and in the past few months foundations have been laid for a long-term approach. This takes time and ingenuity; channels must be cultivated and preliminarily educated. Newspaper space has been tight during the last year and crowded with war news. But newspapers are only one channel to bring the C.P.A. to the attention of the public. The trade journals and periodicals—of which there are many hundreds—can and will use the right kind of material if it is given to them. I see wide opportunities, if handled adroitly and well, to channel into such publications current comment and information based on articles appearing in our monthly publication. Digested and couched in popular, smoothly-written, non-technical language, we can get over a message of the skill, the responsibility and the great helpfulness of the C.P.A. in all industries, trades and businesses. We can make the public conscious that we are the ones best qualified and competent to serve and advise the businessman in a great many other matters besides the mere auditing of his accounts, and also we can do something to plant the seed in the minds of the medium and small-sized businessmen of the worth and utility of regular audits.

For example, I visualize a campaign—if you want to call it that—through the trade papers and journals, to emphasize that every business transaction that is not an ordinary day-to-day transaction may have widely different results in tax calculations if effected one way or the other, and that the only wise and safe thing to do is to consult the C.P.A. for tax advice *before* the transaction is arranged.

Many of you who read the Herald-Tribune yesterday may have seen the full-column article in the business section dealing with the subject of Certificates of Non-Neces-

sity. That article is typical of what I mean, it was based on information supplied by our own Society.

It is only a short step, to expand such an approach to radio broadcasts directed toward the small businessman, educating him on the importance of proper accounting, some of the mechanics and principles, and the accounting and tax problems he faces in his business from day to day, coupled with the suggestion of the valuable help the C.P.A. can be to him when consulted promptly and regularly.

This is just a look into the future: something else our technical assistant can work on and what we need him for—and for which, if it is to be done right, he will eventually need an assistant.

Then comes our veterans' problems. A State-wide committee composed of many members, with area subcommittees, is now in process of formation. This committee will assist our own member veterans in reorienting themselves, by retraining and special refresher courses. This committee, I am happy to announce tonight, will be under the chairmanship of our new Vice President, Charles H. Towns. It will concern itself also with non-C.P.A.'s who have been staff members, and will cooperate with advisory agencies or groups being set up locally through the State to counsel and assist veterans generally who propose to enter business for themselves. Our placement service, under Donald Bellows which has functioned so well during the war years, will fit into this program excellently and help in finding jobs for returning accountants and, with State-wide activity, the time will come soon, I expect, when he too will need an assistant.

We hope this coming year, with an early start, to succeed in having the State Legislature pass the C.P.A. bill introduced this past winter which, unfortunately, died in committee. Several improvements in the bill have been suggested and they are now being considered. The Board of Directors is going to work actively on this legislation during June and it is hoped by the end of June everything will be set to introduce a bill in the Legislature the first day it opens.

One other activity of the Society that has been a great success for many years past is the Up-State Conference. Whether we shall be able to repeat in September the splendid Conference we had last year at Lake George seems doubtful in view of the current ODT regulations. Our four up-State chapters are growing in membership and in local influences. Ideas are afoot to step up the activities of the chapters and they are demanding that they have a Conference. Perhaps complying with travel regulations we can work out a meeting at Rochester, or close by.

The addition of several vice presidents to the corps of officers makes it possible to divide up management responsibility and duties in a manner that will make for more and better coverage and enable expansion of activities to proceed smoothly and expeditiously along the lines I have mentioned. We are certainly going to keep Went Gantt pretty busy. He has done a fine job and I know, from talking with him, he looks forward enthusiastically to the new things we have in store.

In what has been said, I may have used the pronoun "I" more than I should have; I did so mainly for the purpose of informal, intimate, person-to-person report. Understand that this program is not mine: it is the development of the combined efforts of your officers and Board of Directors under Henry Horne's presidency, and I am reporting for

them, merely adding a few personal ideas of my own on public information that have not yet come before the Board for its consideration.

The new Board of Directors takes over on October 1st. It is a grand Board and it's going to be a lot of fun working with it. The incoming Board has full power to pass on and activate the year's plans and programs, and until then this preview I am giving you is merely tentative; but I feel certain that a good deal of the program, if not all, will find reflection in our coming year's activities.

And now, finally, an urgent request. Our Society has about 77 committees comprised of about 650 members. Too many members have not yet volunteered to serve on committees. It is and will be through committee activity that you actively participate in the work and the aims of the Society. We especially want the younger members to become more interested. I appeal to you younger members to identify yourselves in this part of professional life. It will be helpful to you, in knowledge and in friends gained. Write to the Society, please, volunteering for committee service and stating the several committees you would like to serve on if appointments are available.

Later this evening we shall have time for discussion and questions and I do hope some of the members will get up and tell us what they have on their minds and give us some ideas. This is your Society and it now has nearly 5,000 members. We have plenty of things to do and more we can undertake. Write to the Society and give us your ideas and, as the year goes on, if you "get a flash idea" let us have it in writing then. We welcome suggestions and they will have our full consideration.

The Position of the Woman Accountant in the Postwar Era

By JENNIE M. PALEN, C.P.A.

THE Bureau of Foreign and Domestic Commerce of the U. S. Department of Commerce recently published figures which indicate that the public practice of accounting is the most lucrative of the professions. Vocational advisors are in agreement that it has been the most difficult of all the professions for women to break into. And if you will accept the testimony of those women who have succeeded in piercing its armor, even to a woman it is a most fascinating occupation.

In spite of prejudice, about 250 women in the United States have managed to obtain the coveted C.P.A. certificate. There is even an American Woman's Society of Certified Public Accountants, with members from more than half the states. Some of these women are in public accounting practice. Some have opened accounting offices of their own. Many have very good posts in industry or government. A number have achieved positions which command respect, both within and without the profession.

Ten years ago an accountant to whom a young woman applied for staff work told her that he would go out of business before he would employ a woman on his staff. Today we are witnessing a complete reversal of this attitude. Accounting firms are combing the field for women accountants. Three years ago, the New York State Society of Certified Public Accountants appointed a Committee on Wartime Problems, one of whose functions was "to foster the employment of women as staff members as a wartime measure and develop client acceptance of this practice." A sub-committee of women members was appointed to help carry out this function.

Because of the prejudices which had turned qualified women to other fields, and the discouragement which colleges had offered to women who wanted to study accounting, there weren't nearly enough women to meet the demand. The woman C.P.A. was a find, accounting seniors were snapped up before graduation, and even women who were not accounting majors but had had some training and a few years of good bookkeeping experience were considered. By May 1, 1943, according to statistics compiled by the War Manpower Commission, of 9,820 accountants employed by 954 firms, 821, or 8.4%, were women. In the two years since that date the percentage must have risen considerably. In a survey made by New York University one large firm reported that women comprised 26% of its staff.

Remembering prewar rebuffs, women are pausing, now that the end of the war seems not too far distant, to appraise their postwar prospects. Does this right-about-face represent a permanent change in attitude, or will the end of the war see the end of their hopes?

JENNIE M. PALEN has been a Certified Public Accountant of New York and a member of the Society since 1923. She is presently serving as a Director of the American Woman's Society of Certified Public Accountants.

Reprinted from the May 1945 issue of THE ACCOUNTING FORUM.

Changed Conditions

There are several excellent reasons for believing that women have gained a permanent place for themselves in accountancy.

The first of these reasons is a genuine shortage of accountants, which started long before the war. The last twelve years have made heavy inroads upon accountants' staffs. Since 1933 the government has absorbed hundreds of them to administer the Securities and Exchange Commission, the Federal Power Commission, the Federal Income Tax Bureau, and a dozen other bureaus and commissions. Then came the tremendous losses to military service. The War Manpower Commission's figures show that by the spring of 1943 accounting firms had lost 32% of the permanent staff members to the armed forces, and that additional losses of key men to industry were so severe that the supply was only 50% of the need. That was two years ago. Conditions have grown steadily worse.

After the war, some but not all, of the men in service will return to public accounting. Many will want to have a fling at something else. Of those who were absorbed by industry and civilian government, few will return to public work.

Then too, most new recruits to the profession come from the accountancy students graduating each spring. For the next few years there will be a few young men in this category.

The second reason is the steady increase in the services which accountants are called upon to perform. Those same bureaus and commissions which swallowed up so many accountants called upon industry for voluminous reports which accountants were required to prepare. There has been so much new work that accountants have had to decline many engagements. Some of this new work, of course, arose out of the war and will vanish with it, or soon afterward, but much of it is permanent and will call for plenty of accounting personnel.

A third factor is woman's established position in so many well-paid and important posts in industry and government that even in accounting circles it must be evident that the old prejudices were pretty far-fetched. As far back as 1942 THE JOURNAL OF ACCOUNTANCY confessed that its previous prejudices against women in accounting now have "a slightly 'Life with Father' tinge."

The fourth contributing factor is the length of this war, which has given women an unprecedented opportunity to demonstrate their worth and has provided ample time for accountants and clients to become used to the woman accountant.

The changed attitude of the colleges is the fifth encouraging sign. THE WOMAN C.P.A. reports that in 1943 the American Woman's Society of Certified Public Accountants questioned fifty colleges in twenty-nine states on their experience with women studying accounting, and that the general theme of the replies was expressed in the following statement made by the dean of one of the larger universities: "We have never encouraged women to become interested in the public practice of accounting, although we realize a mistake has been made and we are now endeavoring to correct it." The personnel director of another university wrote: "The field is definitely a growing one for women, at least while the war lasts. By peacetime, women will have proved themselves capable and will never again be discarded in accounting firms." More recently the dean of one of the largest universities commented that while he is not sure

how women may be affected by post war clashes over qustions of seniority, he now feels definitely justified in encouraging women to study accounting.

The sixth indication of the woman accountant's changed status is the new attitude expressed by the leading accountancy magazines. They have said some very kind things about women accountants, for which we are warmly grateful. In March 1945, with the end of one war in sight, THE JOURNAL OF ACCOUNTANCY, the official organ of The American Institute of Accountants, presented an article outlining the educational objectives of the Institute, including a refresher course for returning veterans, in which we find this statement: " . . . the accounting profession . . . requires the highest type of personnel —men *and women*"—(the italics are ours) "who are well grounded in liberal education and who possess broad, accurate knowledge of essential technical subjects." Here, to one who knows the careful thinking that is back of all the JOURNAL publishes, is acknowledgment that women have achieved a permanent place in the profession.

Testimony of Employers

The seventh last reason is so important that it outweighs all the others put together. It is the testimony of those who are now employing women accountants. These men, partners in the larger accounting firms, all leaders in accounting thought and men in the forefront of accountancy's activities, have given, with heart-warming frankness and sincerity, an overwhelming endorsement of the woman accountant and a promise for her future. A cross section of these opinions, solicited in March 1945, presents unimpeachable testimony that women on public accountants' staffs have been highly satisfactory, that clients have not objected to them, that the seniors whom they were assigned to assist liked them, that they are to be kept on after the war, and that they will be advanced in rating as they merit such advancement.

The first accountant interviewed was a senior partner in one of the largest firms. He summarized his views as follows:

"We have several women on our staff at this office. Every one of them is highly satisfactory. No client has offered a single objection to them. In 95% of the cases, the seniors to whom they have been assigned have preferred them to any other assistants and have asked to have them again. We intend to keep all of them after the war, if they will stay, and to advance them as they rate it. One is due to be rated a senior now. Some have done out-of-town work. We are not sure whether we can assign women to take charge of engagements with men as asssistants, as most of the assisstants are older than the women, but we are willing to go along with this situation and let it work itself out."

The second accountant interviewed, senior partner in another large firm, said:

"There will never again be any question about client acceptance of the woman accountant. That question has been settled forever. Clients do *not* object.

"Prejudice against women in accounting is dead.

"There is no question that those with above average ability will be kept, but women will have to compete for their jobs with men, especially returning service men. Except in those firms whose work is largely local, the men will have an advantage in that their assignment is more flexible. In cases where out-of-town assignment is not es-

sential, competition with men will narrow down to ability alone. In small and medium-sized firms, women will be as flexible of assignment as men and will be under no handicap whatever.

"The women on our staff are receiving the same compensation as the men, and will be promoted as they earn such promotion."

A letter from a third accountant, partner in charge of personnel in another large firm, reads in part as follows:

"We have had women on our professional staff since February 1942. Most of them have major degrees in accounting. Some had the advantage of some years practical (but not public accounting) experience. . . .

"They now occupy junior, semi-senior and light senior positions. We see no reason why they should not continue this progress in the even higher fields, but it must always be remembered that the percentage of men who can progress into top senior, supervisory and partnership positions is quite small.

"There was at first some reluctance on the part of senior men to take women on to assignments. Circumstances soon dispelled this reluctance, and generally speaking, it is my opinion that in most cases ability alone is now the controlling factor in the matter of assignments. . . .

"We intend to retain some of our women staff accountants when men return from service. Naturally, we shall do as we would in the case of men—retain those best suited to the needs of our practice. We do not yet know whether they will handle the larger jobs in the office. We are satisfied, however, that there will always be a place for women with the necessary technical training and of more than average intelligence at a senior level as in-charge accountants on medium-sized and similar jobs."

A fourth accounant, senior partner in a large firm, writes:

"We interviewed a good number of young women for our staff and employed several. They have made good and we intend to retain them permanently.

"I believe there is a real opportunity for women in public accountancy provided they are willing to secure a reasonable basic training beforehand and then are willing to study. In other words, that they are really interested in accounting as a vocation and not merely as a temporary means of earning a living. Any prejudice against women probably has disappeared. At least, it has in my firm. We probably will always have a certain number of women on our staff whether or not competent men accountants are available."

A fifth firm, a very large one which has employed a significant number of women, commented:

"'Those who are adapting themselves to doing the work as men have done it are being generously accepted; those expecting the work to be arranged to their convenience are not fully accepted. These criteria of usefulness may be the real test when veterans return and men generally are available."

A partner in a sixth firm, another very large one, said when interviewed:

"We are using a considerable number of women, mostly as juniors, some as semi-seniors and some in higher ratings. Some are of course using their jobs as a stop-gap but many are serious. All are regarded as satisfactory and a number are definitely of superior caliber. Some are so good that clients have tried to steal them.

"They like to go out of town and we send them out in groups of two or more.

"The men on the staff like them.

"Clients have offered no objection. Whether they will do so after

the war remains to be seen but certainly there has been ample opportunity to break any prejudice down.

"Unquestionably, several will be kept after the war."

Quotations from other interviews and letters would furnish only corroborative evidence. There was no dissenting voice, except one failure to reply which may indicate disagreement or may signify only lack of time or interest. The preponderance of approval is so great, however, that a few dissenters would not materially alter the situation.

Qualifications Needed

The letters quite rightly lay stress on the need for special aptitude coupled with thorough training. Accountancy is not a field for the lazy or unintelligent.

As part of their daily tasks accountants must shoulder responsibilities which are among the heaviest imposed by the business world. Administrative policies, bank loans, bond issues, capital stock issues, acquisitions of businesses, in fact every type of financial transaction, are based upon the findings of accountants. The penalties of being wrong are shockingly severe.

The larger firms prefer to employ on their staffs only those who are eligible for the C.P.A. certificate, and the staff member who does not obtain the certificate will find small opportunity for advancement.

The requirements for the certificate vary in the different states. In New York State, it is necessary to be a college graduate and the college must be one which has been designated by the state as an accredited school. Before the certificate is granted, the candidate must have completed at least two years of experience in the employ of a certified public accountant in no less grade than that of junior accountant.

The certificate, valuable as it is, does not end the period of study. To be a top-grade accountant it is necessary to read constantly to acquire broader knowledge of business procedures and to keep abreast of all the new legislation affecting business, the new tax laws, the new developments in accounting thought. It is important to learn to use English correctly and effectively, because at the completion of most engagements the accountant submits a written report to his client, on the excellence of which he is judged. It is a permanent record, over his signature, and any flaws in it remain to plague him all his life.

Every occupation has its personal problems as well as its technical ones. The accountant must be able to meet people, executives and subordinates, with self possession. He must frequently meet and conquer hostility. Examinations of accounts disclose errors. Some are careless, some intentional. They disclose inefficiency, sometimes in high places. They sometimes disclose an appalling disregard of the rights of creditors or stockholders. The accountant's reputation and personal fortune are at stake when he certifies financial statements, and he therefore must in some way manage to have all important errors corrected and all essential information disclosed. To do so and retain the goodwill of the client and of the client's employees requires considerable self-control and persuasiveness.

Accountants are expected to be impartial. They are not permitted, as are some other practitioners, any bias, or any silences, in favor of their clients. They are required to state the facts as they see them and this sometimes puts them, as can be imagined, in some pretty difficult spots. A study of newspaper articles, court decisions, and pronouncements of the Securities and Exchange Commission during the past twelve

years will show to what high standards they are held by the courts and the public.

The successful accountant must have sound judgment, unquestionable integrity, tact in dealing with others, plenty of imagination, and a great deal of physical stamina. These are the attributes which get a junior a job and make him worth promoting.

All these qualities, together with keenness of mind and steadfastness of purpose, women may and do possess or they would never have succeeded in breaking into accountancy at all. Those few who have had the opportunity have shown that they can do whatever is required of the accountant, at any level. Women in the other professions, in merchandising fields, in publishing and advertising offices, and in industrial plants have proved themselves competent to lead and to supervise others, both male and female, and those women who have reached key positions in both public and private accounting have demonstrated that they can do likewise.

Some of the accountants questioned reported that they had already lost some good women staff members to clients. As has already been brought out, there are only a few top positions open at any time in the accountant's office and many capable men after five or ten years gravitate to excellent positions in industry. In fact, accounting firms are proud of the number of their graduates who occupy important posts in the busines world. No doubt the woman accountant will follow their example in many cases.

We Are Known by the Company We Keep

By Thomas W. Byrnes, C.P.A.

THERE is an old saying "Birds of a feather flock together." The November 1944 issue of the New Jersey CPA Journal contained a description of an incident which although it possessed an element of humor carried also a note of warning to certified public accountants. The article dealt with a CPA inquiry instituted by the president of a large corporation. The report was very favorable to the accountant until the last sentence which read "The only breath of scandal is that lately he has been seen in the company of a notorious businessman of doubtful reputation." The implication is obvious.

Young practitioners setting up for themselves are often flattered by the attentions of apparently prosperous men of affairs. Such notice may lead to disastrous consequences unless the favored ones are well grounded in their standards of honesty and business and professional ethics. Temptations in the way of social recognition and fees too often lead a young accountant to do things he may later regret.

The writer has from time to time been the recipient of confidences of numerous of his students of the past thirty years. These young men have faced many embarrassing situations in which refusal to accede to demands, if no adequate solution could be found, meant loss of remunerative accounts. Among them, one is recalled where a treasurer issued to a bank a statement of a close corporation. Although the corporation's independent accountant conducted a monthly audit he had not been asked to prepare or approve the statement. The bank requested certification and the treasurer then referred the matter to the auditor. Comparison of the treasurer's statement with the records showed the omission of liabilities. The client was an important one in its industry and its account and influence meant much to the young CPA, who now had to do something. He could not certify the erroneous statement, and to issue another of the same date showing the omissions of the treasurer was unthinkable. What to do? Inasmuch as a month had passed since the date of the statement in question, and as the corporation closed its books monthly, the affair was settled by informing the bank that the auditor was then preparing a later statement, which in due course was sent to the bank. This was an instance where fortunate attendant circumstances furnished a simple solution, but most situations of this sort are not so easily resolved. They may become severe tests of the CPA's integrity. When one is struggling to obtain a foothold in the business or professional world and is assuming at the same time serious economic responsibilities, the temptation to yield is great, but the peace of mind resulting from strong adherence to the principles of right is not the only reward. A reputation for honesty and fair dealing with clients, colleagues, and the public, is bound to result ultimately in greater and much more satisfac-

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tory economic security. A change of auditors is questioned by banks and other credit grantors and the true reason is soon brought to light to the honor of a displaced practitioner.

In these days of high income taxes and required compliance with the regulations of so many governmental agencies the lot of the conscientious CPA is not a happy one. The active practitioner is frequently affronted by remarks to the effect that there are "safe" ways to reduce taxes and to "avoid" bureau regulations, that "everyone is doing it," and that he is not "smart" if he is not able to suggest ways and means of accomplishing these things. The alert professional through constant study knows the affairs of his clients much better than the latters' lunch-time advisers, and the accountant should tell such clients in no uncertain terms of his opinion of and the penalties for violations. Any client worth retaining will respect him for the expression of his views.

The preparation of statements, particularly of costs upon which governmental purchases and renegotiation and termination of contracts are based, imposes a great responsibility upon CPAs. A reputation may be ruined if it is proved that fictitious items were included and that the certifying accountant did not detect them. Also, in cases where an auditor suspects but is not permitted to prove that a client is doing something to obtain higher than authorized ceiling prices for his merchandise, the auditor is faced with a problem. It is not the writer's intention to dwell on the accountant's responsibility in matters of this kind. That subject has been admirably presented in earlier numbers of the New York Certified Public Accountant, in the March 1945 issue, and in Bulletin No. 21 of Auditing Procedures of the American Institute of Accountants. The thought here is merely to warn young practitioners of possible pitfalls in accounts and the consequences of negligence or in acquiescence in improper practices of unethical clients, also to remind them that they are judged by the standing of those with whom they associate.

Today we are living in an era where comparative youth—35 to 45—is in the saddle and where, by the aforesaid, years of experience and human contact are considered not only as of no value but also as definite handicaps to progress. But if the smart young business and professional men who pretend to know all the answers and who measure success by material possessions alone, will indulge in a little introspection and then look around, they will discover that in the long—and short—run, the terribly trite maxim "Honesty is the best policy" still pays handsome dividends in sound sleep, the respect of the community, and also in the coin of the realm.

Partnerships and Close Corporations

By A. S. FEDDE, C.P.A.

Conditions peculiar to such forms of enterprises, and situations affecting ownership interests therein of individuals and estates

WHILE the separation between partnerships and close corporations is not very wide, and in many respects the two kinds of concerns have similarities, it will be best to discuss them separately.

PARTNERSHIPS

The accounts of special interest in a partnership are those recording income and the equities of partners.

While general partners are individually liable for partnership debts it is not expected that the accounts of the concern will record more capital than it is proposed to employ and that the partners are able and willing to use in the enterprise. The accounting viewpoint is that of separate entities as between a partner's capital in a business and his asset values outside the business, and accounting for the partnership and the partners' equities therein takes no account of whether apart therefrom he is rich or poor. His worth outside the businesss, though not entering into the accounts may, however, be of interest to credit grantors and may also have been the subject of consideration by his partners at the time of forming the partnership.

The books will show credits to the individual partners' accounts for capital contributed or profits left in the business. They may also show in separate accounts debit balances for withdrawals, treated as debts to the firm, or credit balances for money advanced to the firm, which, from the standpoint of creditors, are not assets or liabilities similar to accounts with outsiders, but are considered respectively as diminishment of capital and increase of capital. The partners may have their arrangement as to what accounts shall constitute capital in the regular employ of the business and what are loans to or by partners, but in a balance sheet of the partnership all balances in partners' accounts should ordinarily be grouped in one section to show in its aggregate the equity of partners and in its detail the amount which is regularly at the risk of the business separate from any temporary balances. The contribution of a substantial amount

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shown as capital just prior to a balance sheet date, without intent to leave it in the business, could hardly be considered as other than "window dressing." It might, however, leave a trail to be followed by creditors in the event of partnership insolvency.

The original contributions of capital may be of various kinds,—cash, tangible properties, or intangible property or a combination such as might be constituted in a going business. If a business is acquired by purchase at more than the value of the net stated assets the excess is being paid for goodwill or other intangible assets. If such business is acquired by the amount being credited to a partner's account, his credit includes the amount at which goodwill was taken in, and if no arrangement is made for its payment it would remain to his credit until his withdrawal from the firm or his death when it would be paid for in accordance with the applicable provisions in the partnership agreement for liquidating the partners' credit balance.

Goodwill may remain on the books indefinitely at the price paid or credited to the partner bringing it into the firm. It stands at historical cost unless arbitrarily written down with the consent of all the partners. Often dissatisfaction is expressed that a balance sheet does not show, except in its current asset section, the true values. Goodwill is an example of an asset that is not expressed at current value. It may be present and have a value but will not appear as an account unless purchased, and except by purchase there can be no accurate determination of its value as it depends on future events, not past, unless someone is sufficiently sanguine of the accuracy of his forecast as to back it with his money. Once having been purchased it is not expected that it will lose its value—though that often happens. For some purposes, an arbitrary formula is applied to arrive at a current valuation figure, but that is an expedient only and does not determine true value unless the formula is always accepted and the business continues for a number of years on exactly the same profit level, neither higher nor lower than in those past years of which the profits were used as elements in the formula.

That the parties to a partnership must be legally competent and that the business, conducted with a view to profit, must be lawful and that there must be an agreement of some kind, oral or written, is elementary.

In the absence of specific agreement as to the division of profits and losses, they are apportioned equally. It would be a rare partnership that could continue satisfactorily without a written agreement with respect to all important matters. A dozen persons might operate as a partnership on merely an oral agreement with greater safety from disturbing litigation by the trustees of a partner's estate or by a retired partner than a partnership of two persons, as at least in the former case there would be corroboration of the intent, and possibly precedents to indicate the accepted treatment of particular situations. But there might still be trouble for lack of any agreement on certain points not covered by precedent.

The partnership agreement, specific, complete, and applicable to the particular enterprise, should be set forth in "Articles of Copartnership," as the written agreement is termed. Phases of the agreement not pertaining particularly to the accounts, such as a description of the undertaking, scope and duties of partners,

and special causes for dissolution, will not be elaborated upon here. However, the accounting as to partners' interests will be affected particularly by clauses pertaining to capital contributions and changes therein, interest on capital or other accounts of partners, withdrawals as salaries or profits and treatment of undrawn profits, distribution of profits as such or as salaries or commissions, method of accounting and agreement on completed accounts, procedure at dissolution and settlement, insurance on partners' lives, and the rights of withdrawing partners or estates of deceased partners.

Capital and Changes Therein. The amount which each partner shall invest in the business, and in what form, should be specified not only as to the original contribution but as to further contributions if contemplated, and the manner of making them—which could be by restricting the withdrawal of profits. A subscriber to stock in a corporation is not a stockholder until his obligations have been fulfilled and the stock has been issued. The arrangement as to capital in the case of a partnership should, if possible, be as precise as a stock subscription. Capital contributed is of course credited to the capital account of the contributing partner.

Interest on Capital or Other Accounts of Partners. In the absence of any mention of interest on capital, disputes may arise where capital accounts are unequal or disproportionate as to profit sharing or become so after a lapse of time. Often capital accounts are unequal and sometimes so by reason of a special type of service which a partner may be capable of contributing in lieu of a greater capital investment. Usually profit and loss will be charged with interest on the capital, the credits being entered to the capital accounts of the various partners. The balance of profit after being diminished by such charge, which is a distribution and not a cost, does not represent the actual profit of the enterprise but the remainder of profit divisible between partners, after a distribution somewhat similar to a dividend on preferred stock in a corporation.

Withdrawals as Salaries or Profits and Treatment of Undrawn Profits. Where division of profit or loss is to be made on the basis of capital, there should be specific definition as to what constitutes a partner's capital; whether capital is considered to be diminished by borrowings—that is withdrawals in excess of those for which provision has been made—or whether only interest is to be charged on such withdrawals or loans; and whether undrawn profits or other money left in or put into the venture shall be treated as capital participating in profits or only as advances or loans entitled to credit for interest. The importance of a proper agreement in this respect becomes apparent when the ratio of profits to invested capital is greater or less (usually much greater) than the legal interest rate.

An agreement may provide for periodic withdrawals either designated as salaries, shares of profit or a combination of both. Amounts to be withdrawn as salaries are usually related to the service to be performed by each partner, and the possibility of a partner not performing the services expected, due to prolonged physical disability or other causes, should be provided for in the agreement, otherwise the question may arise as to whether withdrawals shall be treated as salary chargeable to profit and loss prior to division of profits or, under certain circumstances, as withdrawals chargeable to the particular partner's capital or, with the same ultimate effect,

as withdrawals against his share of profits. If the withdrawals are charged as salary naturally the charge to profit and loss becomes shared by all, but if not, he stands the charge alone.

Distribution of Profits as Such or as Salaries or Commissions. It is important that what shall constitute the partnership concept of profits should be clearly defined, and especially so if any payments are to be based on profits, such as payments for goodwill or for technical or management services.

The profits to the partners of a partnership are comprised of the results of operations without (or before) any charges to profit and loss which are contra to credits given partners' accounts — that is, before interest on partners' capital, or salaries or commissions to partners. There is this difference between the profit of a partnership and that of a corporation; a corporation has a net profit after salaries or commissions to stockholder-officers, whereas a partnership has first a profit on operations and after certain adjustments, affecting only partners, it has a divisible remainder of profit or loss.

If a partner is to receive commissions due to a certain activity such as conducting a department of the business there should be a clear agreement how it shall be computed and, if on the net profit of the department, specifically what charges such as partners' salaries, share of advertising or other particular or general expenses shall be taken into account before arriving at the base for computation of the commission. Fortunately income taxes do not enter into partnership accounts except that there is in New York a four per cent unincorporated business tax on adjusted net income and in some other states there are taxes based on income of partnerships. To pay a commission, which is chargeable as an expense of the business, and base it on profits after taxes on income, in the case of a partnership at present requires only a simple calculation, but such an arrangement in a corporation may cause almost endless trouble and worry. Though not exactly pertinent to a discussion of partnership accounts, the warning may as well be included here as in the second section of the lecture (close corporations), that if a commission in a corporation is to be paid on profit, a formula should be devised so that it may be determined on an amount prior to the deduction of the various taxes on income which, of course, are calculated on the profit after the charge for commissions. It could be based on an amount composed of profit before such taxes and the commission, but after deduction therefrom of a predetermined percentage in lieu of the actual taxes chargeable.

Method of Accounting and Agreement on Completed Accounts. The manner in which a sole proprietor keeps his accounts is his own affair, providing they also serve the purpose of taxing and other government authorities, but in association with others it is important that the method should be determined and agreed upon. It should be provided that the accounts be kept on the double entry system and in accordance with generally accepted accounting principles consistently observed. There is a choice between the accrual basis and the cash basis, and the latter is frequently adopted by professional or other service firms. If the cash basis of accounting is chosen, the agreement should specify how and when the profit is to be determined and whether allocable, when realized, on the basis of distribution to the partners in the period when earned by the rendering of service, or at the time of reali-

zation, — having in mind that the rates of participation in profit and even the number of participants might vary in different years. On the cash basis there should also be agreement as to expenses and costs paid out, whether costs directly applicable to certain revenues not realized at the year end should be carried over—that is, treated as assets at the closing date. If revenues when realized are to be allocated to the year in which earned, each fiscal year will have its own profit and loss or income account kept open until all revenue earned in that period has been realized, though the aggregate shares of what has been realized in a given period, even if earned in more than one period and accumulated in more than one income account, will be carried each year to the credit of partners' capital accounts.

The cash receipts and disbursement basis may be simple in the case of an estate but in the case of partnerships, such as law, accounting, or other service partnerships, with the addition of partners or changing of the rates of participation in earnings there may be many complications in the determination of partners' interests. Partners may not be versed in accounts, and whether the agreement specifies that the accounting shall be on the accrual or cash basis it will be well to provide at the outset for the appointment of a qualified independent auditor to examine the accounts periodically with special reference to seeing that effect is given in the accounts to the accounting specified in the agreement.

Provision should be made for a method of agreement on accounts completed for any period. This may be by means of sets of the financial statements being signed by all the partners, by means of the absence of objection to financial statements within a stated time, or acceptance of the results as shown on the U. S. Return of Income. The "Return," however, fails to record the remaining balances of assets and liabilities and partners' balances. Such agreement should not prevent adjustment for palpable errors or for a condition which could only become determined at a later time.

Insurance on Partners' Lives. In some situations it would be obviously desirable to carry insurance on a partner's life. It is unnecessary to try to enumerate all the circumstances under which a partner's death might be followed by financial loss or embarrassment to the firm, but they are present in many partnerships and should be recognized. When partners are insured it should be clearly understood whether the firm or certain partners are to be charged with premiums and who are the beneficiaries in the event of death, also what shall be done about the policies in event of dissolution of the firm. A natural arrangement in case of the latter would seem to be the option to the insured to take over the policy upon the amount of the cash surrender value being paid to those previously charged with the premium payments.

Rights of Withdrawing Partners or Estates. Dissolution of a partnership, in most cases, does not involve the stoppage of business, but marks a point of time at which the interests of the individuals composing a partnership are determined, especially those of a partner withdrawing or of his estate in case of a partner's death. While a partnership is, of course, dissolved upon the death of a partner, the partnership agreement should also provide for other contingencies such as a partner becoming mentally or physically incompetent to continue in the business or voluntarily withdrawing from the firm. It should provide

the basis of settlement, including the manner of valuation of assets if they are not required to be sold. The surviving partners are not trustees but have possession of the assets as survivors to liquidate the business. Ordinarily, if they take over title to the assets at an estimated value instead of selling them it must be with the consent of the representatives of the estate. There is a good deal of law applicable, in the absence of agreement, to the rights of the estate of a deceased partner and the survivors. Much trouble may be obviated by agreement in the copartnership papers as to what shall be the rights of the various parties in the event of dissolution of the partnership.

Procedure at Dissolution and Settlement. If the partnership agreement clearly sets forth provisions for the situations mentioned, the accounting can be expedited and the amount due should be capable of determination. If the remaining partners are not to liquidate the business but may continue it and assume personal responsibility for the partnership debts and the amount due the estate, the agreement should so specify. The estate, of course, is not thereby relieved of liabilty to the creditors of the former partnership, but the business can continue as a going concern. The agreement should also specify the manner of settlement, when and how payments are to be made, how loss, if any, upon dissolution is to be apportioned, and it might also provide that the interests are to be determined as at the close of a month,—to avoid having the accounts made up at an odd date.

Circumstances peculiar to any partnership will naturally dictate the sort of provision for dissolution and settlement that will seem equitable and feasible and whether the proposed methods of settlement can be carried out without life insurance.

Where a substantial part of a business is attributable to the efforts of one partner and he has not been paid or credited on the accounts for the goodwill developed or brought in, and the agreement is to provide that in addition to the amount standing to his credit upon his retirement or death, a sum in payment of such goodwill shall be entered to his credit and be paid to him or his estate, the question should be posed: whether such goodwill will continue in the value proposed based on past results—that is, whether business will be maintained at the same level, and whether, unless the amount is provided for by insurance, it could be paid for or whether, in any event, a predetermined value is a fair or even a feasible basis. A fair and more practicable basis might be to determine the amount to be paid upon the basis of business results after the date that he ceased to be a partner.

The partnership accounts should be examined by the representatives of a deceased partner's estate to determine that in the accounts affect has been given to the terms of the agreement; or if the agreement has failed to be specific on all points, that proper principles have been followed. For example, assuming that the survivors may elect to continue as a going concern and they do so elect, the inventories should be valued in a manner consistent with former practice and not at forced sale value, reserves for depreciation should be consistent with former practice, and provision for loss on bad debts should not be excessive. If, however, the former partner had acquiesced in writing down assets such as equipment or machinery, as a going concern they hardly need to be reappraised to find value to be restored on the books. The interim

period between the last time the accounts were agreed upon and the date at which the accounts are to be made up as the basis for settlement should be especially scrutinized.

Even though in the agreement care has been taken to include the manner of dealing with every known or imagined contingency, circumstances may arise which were unforseen or for which there was not sufficiently definite provision and so be the cause of dispute; and therefore a clause for arbitration of disagreements, with the manner of the selection of arbitrators specified, is a precautionary measure that should not be overlooked.

The Income Tax Situation

Inasmuch as partnerships are not taxed as entities under the Internal Revenue Code, but act merely as reporters of income accruing to the individuals composing the partnership, that form of organization has, considering the high rates of taxes on income at the present time, a marked advantage over the ordinary corporate form in the avoidance of double federal taxation of income. This is well illustrated in the case of stock ownership in a corporation subject to an over-all tax rate of, say, 70%, from which the dividend is subject to the taxpayer's average rate of, say, 50%, leaving the owner of the stock with a net of $15 of each $100 earned by the corporation and paid out in dividends, as against $50 of each $100 income received through partnership earnings. The net amount after taxes in the latter case is 3⅓ times that in the former; or to put it another way, his net after taxes on $100 invested in the partnership is equal to that on $333 invested in the corporation. In most cases there seems to be very little difference between the effect of state taxes on partnerships and corporations, particularly when there is taken into account the deductibility in the determination of income subject to Federal tax.

The Internal Revenue Code is brief in its definition (?) of corporation which reads, "The term 'corporation' includes associations, joint stock companies, and insurance companies." The Code includes as a "partnership" a syndicate, group, pool, and joint venture which is not, within the meaning of the code title, a trust or estate or corporation. These "definitions" are so illuminating!

Limited partnerships, under whatever designation, which have charactertistics of the corporate form which provide, among other features, for limiting the liability of all the members, permitted under statutes of certain states, have been held to be "associations" and more truly corporations than partnerships and have been taxed as such. Therefore, in the formation of a partnership in order to avoid double taxation of income, the form, if it is to be other than a general partnership, must be very carefully considered as to statutory requirements and in the light of decisions in order that the purpose may not be defeated.

Even in the formation of general partnerships, of which use is sometimes made in the attempt to split an income into several parts taxable as separate incomes, the rule must be observed that a partner must contribute services or capital or both. In a family partnership a man may make his wife an equal partner by making a gift to her of one-half the partnership capital (paying the gift tax of course), and the Internal Revenue Bureau will recognize the arrangement as a bona fide partnership but will not recognize an equal division of the partnership income merely because of equality of capital unless there is also equality of service. The Bureau will reapportion

the profits to make what it considers to be an equitable distribution as to earnings of capital and services. An agreement merely to assign a portion of profits to another person, while it may be a valid legal agreement, would be considered by the Bureau as a gift of such profits when they have accrued, and the Bureau would tax the income to the person whose services or capital have earned them in the first place. There would be no avoidance of income tax by such an arrangement but also the assessment of a gift tax if the exemption had been used up.

By the use by a partnership of a fiscal year other than the calendar year there can be postponement of tax payment if the taxpayer is on a different annual tax basis. A partner who is individually on a calendar year basis and whose firm is on another fiscal year basis, reports in any year only the income accruing to him through the partnership for its fiscal year ending within that calendar year. If, for example, the firm's year ends on March 31, the partner does not report as his taxable income earnings through the partnership for the nine months from April 1, to the close of the calendar year as income of that calendar year but as income of the succeeding year in which the firm's fiscal year ends. In this connection it should be borne in mind that taxable earnings from the partnership include partners' salaries, commissions and interest on capital even though paid monthly or at other times within the firm's fiscal year. If business should be equally spread throughout the year and tax rates remained constant from year to year there would be no tax saving but only tax payment postponement, but if a profitable pool or syndicate, rated by the Bureau as a partnership, were formed for a limited period there would be an advantage in years of declining tax rates in having a fiscal year ending subsequent to the tax years of the partners.

CLOSE CORPORATIONS

The term "close corporation" is used by Montgomery in the Financial Hand Book and his tax books, Sailiers in the Accountants Handbook, and by Conyngton in Corporation Procedure. For management corporations the designations of "open-end company" and "closed-end company" are used, but I have found no references to "closed corporations." The subject deals with what was defined by the Committee on Terminology of the American Institute of Accountants as "Close Corporation," the definition being given as follows:

> "A corporation the stock of which is held in few hands and not freely sold. The restraint on trade may be provided in the by-laws of the corporation, by definite contract between the stockholders or by a general understanding. In most close corporations the restraint is a 'gentlemen's agreement'."

Close, as an adjective may mean shut in or almost shut in, confined, —as, a "close" prisoner. A close corporation is one therefore that is closely held, the ownershp confined or almost confined within a small group of stockholders.

The most usual type of close corporation is that formed by incorporating a partnership or the incorporation by a few persons of a small enterprise. But the corporate form has also frequently been adopted to hold the properties of an individual with the object of limiting liability, or of putting his affairs in such shape that interests therein might be easily transferred. Some real estate operators incorporate each property separately so that adverse results of one venture may not jeopardize the others. Close corporations may be

incorporated estates controlling large business enterprises, corporations for the promotion of welfare or scientific research, and associations having the characteristics of corporations rather than partnerships, such as formed for development of properties, holding gas and oil leases, and the like.

A change in the form of a partnership to that of a corporation, generally for the purpose of limiting the capital liability, usually results in a close corporation, the stock being held by the former partners and perhaps some shares by members of their families. So far as operation of the business is concerned, it is generally carried on as before even though the partners have been given titles pertaining to corporation officers and its affairs are managed by a board of directors, perhaps in a very informal manner, which is possible so long as the shareholders permit and no outsiders' interests are hurt.

Sometimes there is a tendency to make the officer's compensation as high as profit will permit which, however, may be equivalent to or somewhat in line with the former division of partnership profits. If new stockholders have been added, such as employees who have been encouraged to invest, then, especially salaries to the officers should be related to their earning value to avoid charges of misusing the power of the controlling stock. An employee who has put his money into stock of the corporation gets only what the persons in control are willing that he should have. In some cases he fares very well—in other cases not so well. The outcome to a minority stockholder in a close corporation depends both on the success of the business and the goodwill of the controlling stockholders.

At the time of incorporation I believe the attorney could, without being accused of self-serving, advise the client that there are many difficulties that will be encountered —reports that must be made, government regulations that must be observed, contracts to be entered into, minutes that should be written up (perhaps guardedly as they may one day become subject to outside scrutiny), and countless questions that will come up on which the officers should, currently, have proper advice.

An advantage may accrue to the estate of a stockholder in a close corporation in the valuing and disposal of his share if there is an agreement between the shareholders that, in the event of death or withdrawal of a stockholder, the remaining stockholders will buy the stock at a price determined by a definition of value or a formula. The value for estate purposes is fixed thereby and there is an outlet for disposal of the stock for which otherwise there might be no market.

Where there is no such agreement between stockholders and lacking an open market for the stock, nevertheless, for estate tax purposes, the stock must be valued. An offering of the stock to the corporation or its other stockholders may not bring a bid which the executors feel justified in accepting. The few potential buyers may be expecting a great bargain either at that or a later time. This provides the executors with the dilemma of either selling the stock for less than its value, or having it valued for tax purposes at probably higher than the bid price. In their valuation the taxing authorities may very likely consider 8% as a normal rate to be earned on invested capital and capitalize any excess earnings at 15%, using the average of the earnings and the invested capital of the five preceding years for the calculation, and add the capitalized excess earnings as goodwill to the other net assets. When faced with a valuation as a basis for taxes or in a situation where sale is imperative or desirable,

a minority holder of stock in a close corporation may find himself in an uncomfortable situation.

An agreement between themselves not to sell the stock to outsiders is binding on the parties to the agreement but not on another person who purchases the stock from a holder violating the agreement. However, it would be an extraordinary situation that would tempt an outsider to be an unwelcome investor in a close corporation, as he could expect no other consideration than the other stockholders were willing to accord or which he could exact through the courts.

Occasionally two persons (or two families) hold exactly 50% each of the voting stock. If the two persons are endowed with good sense, and one of the two is the acknowledged leader in ability and also a person of tact so that he can lead in business policies without seeming to put a slight on the other, such a close corporation can operate in harmony just as well as the same two persons in a partnership. When the stock is inherited by the families of the original owners, there may be trouble. If one family has a greater number on the board of directors it will be in control and can appoint the officers. The stock held by the other family will be practically useless in a stockholders' meeting. It cannot oust those in control of the board or elect any new directors. It can only block any change, which requires a majority vote of stock, that the other side might wish to make. Even if an appeal were made to the courts to permit the half interest that is out of control to have an equal voice in management, it might be unsuccessful if with the board in office and their elected officers the affairs of the corporation are prospering. If the certificate of incorporation has a provision permitting cumulative voting, one side might steal a march if the other were caught napping. One half the stock voted cumulatively for, say, four directors of a board of seven could obtain control of the board if the other half of the stock were spread by voting for a full slate of seven. Where the stock is divided evenly between two factions wishing control, the faction that is "out" may possibly be mollified—if peace is desired—by each side agreeing to put enough stock into a voting trust to control, providing they can agree on the trustees.

While in most states three incorporators are required, it is perfectly practicable for one person to own the entire stock even though a few shares should be required to be placed in other names to qualify directors. An estate comprised of a corporation formed to hold all of a person's investments, which may be in securities of large corporations or equities in corporations in whose management and operation the person is interested, is in convenient form for disposition under his will. If there are remaindermen as well as life tenants, the trustees under the will would normally become directors of the corporation and perhaps officers and directors of any underlying controlled corporations. The testator may have provided thereby a simple vehicle for dividing his property but if the trustees have been empowered to continue the holdings of the testator's corporation in subsidiary controlled companies and manage and operate them, he will have provided the trustees with many perplexities. Assume that the assets in such testator's corporation "A" consist of securities in a number of publicly held corporations, there are few problems involved in the administration of the estate. But assume that it also holds a controlling interest in each of corporations "B", "C", "D" and "E", "B" and "C" each holding, say, 75% of corporations "B1" and "C1", a constantly present

problem is how to deal equitably between life tenants and remaindermen.

If an estate centers in one estate holding corporation, it may operate its accounts in estate fashion to show income account and gains or losses accruing to principal, even though that will be a departure from corporate accounting. In the corporate accounts capital and surplus accounts may represent the principal, and an "income undistributed" account the balance of income on an estate basis, and a profit and loss account be operated as an intermediate account to be transferred on estate accounting principles partly to surplus for increases or decreases of principal and partly to "income undistributed" for income accruing to life tenants and available for dividends to the estate trustees for distribution to the beneficiaries.

Where the estate holding corporation controls other corporations, which, perhaps, control still other corporations, the rights of beneficiaries may easily intervene between what a person would do if he were conducting his own affairs and what he must do as a trustee. He must not do what is best for the remainderman to the detriment of the life tenant or vice versa but must use his best judgment to deal equitably toward both. Where it is possible to secure the consent of both remaindermen and life tenants to a proposed course it is well to do so. A controlled corporation may be in financial straits: shall other estate funds be advanced to try to save it? If an unsuccessful attempt is made to save it at the cost of further loss of estate principal, the trustees may be fortunate if they had secured the consent of the remainderman! Shall a controlled corporation disburse all its profits to the estate holding corporation so they may be paid out by way of the estate trustees to the life tenants? I believe the directors of the underlying corporation must use their own judgment—even if they are the same persons as the trustees —as to the course to be taken to safeguard the investment, and whether in pursuit of that course profits of such underlying corporation should be retained in the business. Accounts receivable or inventories may have increased in the ordinary course of the business, and temporarily at least tied up some of the profits so they were not readily available for distribution. But, embarking on a program of expansion of plant out of profits would be fraught with the danger of a lawsuit unless the situation had been discussed with the life tenants and, believing their income would be increased thereby, their assent to the plans is had. In my opinion, barring some unusual or unsound procedure in an underlying corporation, the life tenants cannot look to their income until it comes into the estate holding corporation. Then they can rightfully expect it, though there is still the corporate action of declaring dividends before it can actually come into their hands.

An underlying corporation might use profits since the date of the testator's death to make up a deficit or to increase the working capital which may have been deficient. A beneficiary owning a minority interest in the estate holding corporation, or a life tenant, might not be receiving income earned by such an underlying corporation because the directors, who may also be remaindermen refrain from declaring dividends in order to promote their own interests. The directors would probably have to answer in court as to why dividends cannot be paid and to show good reasons why the corporation could not get along on the same financial set-up as before. The courts will look beyond a corporate struc-

ture in determining the rights of beneficiaries of an estate.

It would seem natural in view of the difficulties put in the path of corporations in recent years, particularly in matters of taxation, if the trend to the corporate form were reversed, especially as to enterprises carried on by a very small group or where owned by a single individual.

Income Tax Situation

Naturally this can only be touched on briefly and only with respect to certain features.

The close corporation may be one subject to the same taxation as a publicly owned corporation, or it may be an exempt corporation, a personal holding company, a personal service corporation, or an association taxed as a corporation.

Exempt corporations require no further mention than the general comment that they comprise such corporate organizations as are not operated with the motive of making a money profit accruing to the members or stockholders. These have the advantage of the corporate form and escape the principal disadvantage, taxation of income.

A personal holding company is defined in Section 501 of the Internal Revenue Code. I shall not repeat the definition, but broadly speaking it is a personal holding company if its gross income is not less than 70%, and under certain conditions not less than 80%, derived from revenues as recited in Section 502—which I shall not quote—but which include dividends, interest, securities and commodities gains, personal service contracts, rents, royalties, etc., subject to certain enumerated conditions; and if at any time during the last half of the taxable year 50% in value of the outstanding stock is owned directly or indirectly by or for not more than five individuals. Section 503(a) and the regulations pertaining thereto define constructive ownership, that is, what is meant by owned "indirectly."

A person is considered to own indirectly the stock, to the extent of his share of a corporation, partnership, estate or trust, and that of his relatives in what might be said to be the vertical and horizontal line, and also any stock on which he has an option, or a series of options on options. A corporation may therefore have a considerable number of stockholders and yet its stock be owned, according to the Code, by not more than five individuals.

With respect to a close corporation, care should be taken to ascertain whether it is a personal holding company, the test being (a) the source of income, in combination with (b) the number of stockholders computed according to the code definition of what constitutes ownership. The tax on "undistributed subchapter A net income" is severe, 75% on the first $2,000 and 85% on the excess. Incorporated estates may easily fall in this category, as also an individual who has incorporated his security holdings. Pools or syndicates obtaining revenue from rents or royalties which find their type of organization classified as an association, and therefore a corporation, may also fall in the category of a personal holding company. Obviously a small group contemplating combining in a business venture should proceed with caution.

A personal holding company will need to know shortly before the close of the taxable year what its income has been to that point, and what it probably will be for the year, in order that its dividend payments may not leave it with undistributed income taxable at such surtax rates. Prior to the Act of 1942, deficiency dividends could not be applied to any but the taxable year which had just ended. A corporation which had its income shifted by the Treasury

Department from one year to another could find itself subject to the surtax even though the combined dividends of the two years equaled the combined net income; or the disallowance of charges, for example salaries held to be excessive, might leave a balance of undistributed income subject to the surtax. The possible injustice in the situation was recognized, and in the 1942 Act deficiency dividends were permitted within a 60 day period after determination of the deficiency in tax.

I am not trying to explain the tax on personal holding companies but to indicate the problem of such companies with respect to correctly and promptly determining income to avoid the very high surtax and the complications encountered if insufficient dividends are distributed.

In a close corporation, whether or not of the personal holding company variety, if substantially owned by one individual, the owner may unwittingly create situations which leave him open to heavy taxes if he attempts to withdraw funds in other ways than as reasonable salary and as dividends or as a bona fide liquidation. Such a person drawing funds and entering them as an account receivable by the corporation from him will probably find himself taxed as having received dividends. Likewise, if he sells some of his stock to the corporation and payment is made out of accumulated earnings either in cash or property, he will have a battle to defend the transaction as a partial liquidation subject to the capital gains tax instead of as a dividend.

A personal service corporation is one in which capital is not a material income producing factor and in which the income arises mainly from the activities of its stockholders engaged in the business who own at least 70% of the value of each class of stock. It is subject to the corporation income taxes but may elect to be exempt from excess profits taxes by having its stockholders include the balance of income for the year not paid out in dividends as though received by them. There are more kinds of net income under the Code than a cat has kittens. Here we have "Supplement S Net Income" and I refer you to Code Sections 391 to 396 inclusive for the details.

Many concerns claiming to be personal service corporations have been denied that classification by the Treasury Department. The partnership form might at this time seem preferable, though in changing from a corporation already in existence, the possible taxable gain upon liquidation should be taken into consideration. Moreover, a partnership continuing the business of a predecessor corporation may find itself classified as an association, taxable as a corporation, if the conduct of the affairs of the corporation continued after the termination of its existence.

The principal accounting problem of the personal service corporation electing to be exempt from the excess profits tax, in this connection, is the keeping of its accumulated earnings so identified that the stockholders may be advised what to include and what to exclude from his income. If such a corporation has been in existence for a number of years there will be earnings of some years the dividends of which will be taxable as not having been included in income reported by the stockholders, such as the years 1922 to 1939 inclusive; and other years, such as 1918 to 1921 inclusive, for which a segregation was made of taxed though undistributed earnings.

As association of a few persons would be considered a close corporation if the classification under the Internal Revenue Code is accepted, under which an association is taxed

as a corporation. Several types of trusts are held to be associations, and even the fact that the number of beneficiaries, in one case, was limited to two did not prevent a trust from being regarded as an association. The Regulation states that the term "association" is not used in the Internal Revenue Code in a narrow or technical sense. If, therefore, there is an association of persons with a purpose to engage in business or transactions for profit and it is in any respect organized or conducted on lines similar to a corporation it will probably be deemed to be one. Regulation 111, Sec. 29. 3797-2 contains the statement "It includes any organization, created for the transaction of designated affairs, or the attainment of some object, which, like a corporation, continues notwithstanding that its members or participants change, and the affairs of which, like corporate affairs, are conducted by a single individual, a committee, a board, or some other group, acting in a representative capacity." There are many decisions which have held various trusts, syndicates, joint ventures, and limited partnerships to be associations.

Code Section 102 which provides for a surtax in the nature of a penalty on improper accumulations of surplus is applicable to any corporation formed or availed of for the purpose of preventing the imposition of the surtax on its shareholders. Close corporations, rather than large publicly owned companies, are vulnerable to the charge that they are improperly accumulating surplus unless they can prove that all the capital and surplus is used in the business. Substantial amounts in cash and securities are viewed with suspicion. It might be kept in mind, however, that a manufacturing company with substantial reserves for depreciation accumultated out of revenue is entitled to keep a corresponding amount of liquid assets available for future replacement, and that there will be such liquid assets on hand representing the reserves unless they have been encroached on by expending the funds in other ways than in the replacement of depreciated assets.

This is not intended to be a discussion of taxes or interpretations of the Internal Revenue Code but in discussing problems of corporations, accounting or legal or both, the question whether to be or not to be a partnership or a close corporation must take into some consideration this most serious of all problems.

Outline of Lecture on Effect of SEC and Treasury Department Policies on Application of Accounting Principles

By CARMAN G. BLOUGH, C.P.A.

(Changes in accounting practice and in the form and content of financial statements and periodic reports resulting from SEC and Treasury Department Regulations)

I. Introduction:

(a) Breadth of title subject precludes all but brief discussion of the subject as it relates to *corporate accounting* and ordinary commercial, industrial enterprises.

(b) Definition of terms

(1) The "art" of accounting (Accounting Research Bulletin No. 9).

(2) The nature of accounting principles (Accounting Research Bulletin No. 7).

(3) The tests of corporate accounts (Accounting Research Bulletin No. 1).

CARMAN G. BLOUGH, C.P.A., is the Director of Research of the American Institute of Accountants. He holds an M.A. degree from the University of Wisconsin, where he also served on the faculty as a teacher of accounting and corporate finance. He has done graduate work at Columbia, Chicago, Wisconsin and Harvard Universities, and has been head of the Department of Accounting at the University of North Dakota. Mr. Blough has served with the Wisconsin Tax Commission and also as Chief Accountant of the Securities and Exchange Commission.

II. Effect of SEC Policies

(a) Introduction

(1) Purpose of SEC Acts—to provide an orderly and informative procedure for the distribution and sale of corporate securities.

(2) Procedures of regulation as related to accounting matters.

(a) Rules and regulations

(b) Withholding or withdrawing security registration (Commission decisions)

(c) Opinions of accounting staff of SEC (Accounting Series Releases)

(d) Deficiency letters and informal conferences

(3) Restricted scope of SEC regulations on accounting—accounting prescriptions of SEC affect accounting of unregistered companies only to extent that their conclusions and rules reflect the best and most useful practices.

(b) Effect upon Accounting Principles

(1) Generally the rules, regulations, opinions, etc., of the Commission have added additional support to generally accepted accounting principles

Presented April 26, 1945, for the Course on Current Problems in Accounting for Lawyers given by the Practicing Law Institute in cooperation with the American Institute of Accountants and the New York State Society of Certified Public Accountants.

(a) Adequate presentation of financial data
(b) Audits and disclosure
(c) Distinction between capital and surplus from an accounting rather than a legal standpoint emphasized
(d) Treasury stock as a reduction from capital rather than an asset
(e) Quasi-reorganizations
(f) Donated stock and promotional expenses
(g) Footnotes

(2) In other areas rules, regulations, opinions, etc., are seemingly based on regulatory concepts and these may not be wholly consistent with other valid concepts of socially useful accounting principles
(a) Write off of goodwill Bulletin No. 24 vs. total write off suggestions
(b) Premiums on preferred stock retired
(c) Income taxes Bulletin No. 23 vs. reported SEC views
(d) Form of income statement—possibility of extension of these ideas into whole area of income reporting—significance of current year's earnings—significance of total earnings reported in a series of statements

III. Effect of Treasury Department Policies
(a) Introduction
(1) Purpose of act to raise revenue; other possible uses.
(a) Attack criminal operations
(b) Aid or retard special businesses, etc.
(c) Advance social or economic theories
(2) Procedures of regulation relating to accounting matters
(a) Tax liability and criminal liability
(1) Courts
(2) Tax courts
(3) Additional assessments
(b) Effect on Accounting Principles
(1) Basic differences from accounting—income a statutory not an accounting concept
(2) General effect
(a) To emphasize need for adequate records
(b) Speed acceptance of some recognized accounting principles—depreciation — unamortized discount on bonds refunded —etc.
(3) Areas of difference
(a) Conflict over inventory methods—basic stock—last in first out
(b) Percentage depletion
(c) Differences between capital and income
(d) Concept of "constructive receipt"
(e) Forgiveness of indebtedness
(f) Involuntary liquidation of inventories
(g) Impounding of insurance from destroyed property
(h) Amortization of wartime facilities
(i) Cash vs. accrual basis
(j) Property acquired in a reorganization
(4) Other effects—high tax rates influence timing of corporate action and so may have effect upon income and surplus

IV. Conclusion—the view of accountant to regulations of SEC—Treasury Department, etc.
(a) When policies are consistent with "tests" of corporate accounting, the effect is to improve general accounting practices even in areas

where there is no attempt to control corporate activity.

(b) When policies are not consistent, regulations tend to become special purpose rules which mean that the corporation must maintain records and procedures which will permit a variety of reports
(1) Internal Revenue
(2) SEC
(3) Stockholders, etc.

(c) From the view of accounting as an "art" there can and should not be any "code" of rules. Principles must be adapted to social and economic concepts of the times and accountants generally are of the opinion that they should never be "frozen"—especially from the standpoint of regulations.

C. P. A. Examinations given by the University of the State of New York May 16, 17, 18, 1945

PRACTICAL ACCOUNTING—Part I

Wednesday, May 16, 1945—1.30 to 6 p. m., only

The Practical Accounting paper consists of part I and part II.

State your examination number on each sheet. Do not sign your name.

Consider carefully each requirement of each problem. Designate each solution by number. Consider technic and neatness as carefully as mathematics.

Answer the questions as directed under each group.

Group I

Answer one question from this group (25 credits). Indicate selection by a check mark (√) placed at the left of the number on the question paper.

1 Prepare, with due regard to form and placement of elements, the following statements for the Magnus Company, cotton cloth manufacturers:

a Balance sheet
b Profit and loss statement
c Statement of cost of manufacture and cost of sales

MAGNUS COMPANY
Trial Balance—December 31, 1944

Accounts payable	....	$ 4,362.00
Accounts receivable	$ 17,444.00	....
Bad debts	450.00	....
Brokerage	5,771.00	....
Cash	86,425.00	....
Capital stock, common	....	200,000.00
Capital stock, preferred	....	400,000.00
Executive salaries	10,800.00	....
Expenses	4,395.00	....
Income from investments	....	15,338.00
Income from rentals	....	4,179.00
Insurance	3,646.00	....
Inventory, finished goods	86,918.83	....
Inventory, fuel	2,097.00	....
Inventory, goods in process	62,437.00	....
Inventory, mill supplies	4,910.00	....
Inventory, property maintenance	815.00	....
Inventory, raw material cotton	67,465.86	....
Investments	378,114.00	....
Labor	216,511.00	....
Mill supplies	15,234.00	....
Prepaid insurance	2,154.00	....
Property and plant (cost)	676,170.00	....
Property maintenance	3,527.00	....
Purchases, fuel	9,360.00	....
Purchases, raw material	144,903.56	....
Repairs	7,252.00	....
Reserve for depreciation	....	384,126.00
Reserve for plant improvement	....	100,000.00
Sales of finished merchandise	....	570,639.00
Sales of waste	....	13,254.12
Surplus	....	121,957.13
Taxes	7,623.00	....
Wages and salaries accrued	....	9,128.00
Water rent	8,560.00	....
	$1,822,983.25	$1,822,983.25

Inventories in pounds were as follows:	12/31/43	12/31/44
Raw material	306,663	150,155
Goods in process (50% completed)	101,752	104,287
Finished merchandise	86,229	23,343

Purchases of raw material during the year were 557,706 pounds. Waste sales during the year were 214,214 pounds. Depreciation of fixed assets amounts to $26,537.62. Inventories are valued on the basis of cost.

2. Requirements:
   a Balance sheet
   b Profit and loss statement
   c Surplus statement

SCANLON COMPANY

Trial Balance — June 30, 1944

Accounts payable	....	$ 80,000
Accounts receivable	$ 640,000	....
Accrued bond interest	....	6,250
Accrued taxes	....	18,000
Bond interest	25,000	....
Buildings	600,000	....
Capital stock	....	1,000,000
Cash	149,675	....
Discount on bonds sold 7/1/42	50,000	....
Discount on donated stock sold from treasury by Uptown Trust Company, trustee	50,000	....
Finished goods inventory 6/30/43	316,000	....
First mortgage 5% bonds	....	500,000
General expenses	35,000	....
Labor	265,600	....
Land	400,000	....
Machinery and equipment	300,000	....
Materials inventory 6/30/43	130,000	....
Materials purchases	610,000	....
Operation expenses	143,000	....
Premium on capital stock	....	100,000
Prepaid insurance 6/30/43	6,000	....
Reserve for bad debts	....	1,300
Reserve for depreciation	....	34,725
Reserve for depreciation on machinery replacements	....	30,000
Reserve for sinking fund, bonds	....	50,000
Sales of finished goods	....	1,830,000
Sinking fund, Uptown Trust Company, trustee	50,000	....
Surplus on donated stock	....	120,000
Treasury stock, Uptown Trust Company, trustee	70,000	....
Unappropriated surplus	....	70,000
	$3,840,275	$3,840,275

Supplementary Information

Inventories, June 30, 1944:

Finished goods (cost)	$274,000
Goods in process (cost)	210,000
Materials	104,000

Bonds mature in 10 years from July 1, 1942. Interest is payable April and October. Bonds were sold at 90.

Depreciation: buildings, 2% per annum; machinery, 7½% per annum.

The reserve for depreciation included in the trial balance is analyzed as follows:

Buildings	$12,000
Machinery and equipment	22,725

Reserve for bad debts is to be 1% of accounts receivable.

Replacements are to be made from revenue. During the year just closed, one machine was removed and was replaced by a similar machine:

Old machine (an original purchase) had a cost value of......	$12,000
Old machine was sold for cash in the amount of.............	3,000
which was credited to machinery account	
New machine was purchased for..........................	20,000

The charge therefor was to operation expenses.

The Uptown Trust Company, as trustee, reports the receipt of income cash during the year in the amount of.............. $ 2,500

This amount was credited to the sinking fund reserve.

The insurance was paid on July 1, 1942, for a 3-year period.

Taxes were charged up each month to operation expenses in the amount of .... $ 6,000

The accrued taxes account was credited.

Taxes paid during the year amounted to.................. 54,000

The tax year ends March 31.

The treasury stock was donated and has all been sold.

A dividend of 10% was declared as of June 30, 1944, payable July 15, 1944.

The Scanlon Company has been in existence two years.

Group II

Answer one question from this group (25 credits). Indicate selection by a check mark (√) placed at the left of the number on the question paper.

3 Requirements:

a Prepare the requisite statement that will display properly the actual and standard costs of production for the operating period of 30 days, as mentioned below.

b Calculate the estimated loss by theft.

The following production statement was prepared by the factory foreman in collaboration with the cost accountant of the Austin Company at the close of a 30-day period of operation:

	Actual cost	*Standard Cost* *Rate*	*Amount*
Units of product produced:			
(200 per day)...........................	6,000	6,000	
Wood and paint department:			
Materials	$ 3,340	$ .55	$ 3,300
Labor	5,550	.90	5,400
Overhead	8,000	1.05	6,300
Machine department:			
Materials	32,000	5.45	32,700
Labor	37,200	6.15	36,900
Overhead	12,000	1.90	11,400
Assembly department:			
Labor	9,050	1.50	9,000
Overhead	3,400	.50	3,000
Inspection department:			
Labor	5,800	1.00	6,000
Overhead	6,500	1.00	6,000
Total cost	$122,840		$120,000

In relation to the standard costs, the following estimates may have to be taken into consideration:

(1) The running of a double shift on any one day reduces the overhead by 20%.

(2) Night-shift wages require an increase over regular wages of 20%.

(3) Daily production is to be 200 units.

An investigation undertaken as the result of rumors that matters were not exactly as they should be, uncovered that the production statement above was in error because of the following:

(1) Production for a total period of five days was increased to 400 units per day by running a night shift in addition to the day shift.

(2) Sales of 1,000 units were made by the factory foreman at cut prices, the proceeds being appropriated by him and the cost accountant.

(3) Employes were paid their night-shift wages out of the proceeds of the above sales.

(4) Night-shift production was not recorded.

(5) Materials used during the night shifts were not recorded.

4 Prepare:

a Balance sheet

b Profit and loss statement

HUDSON MANUFACTURING COMPANY

Trial Balance — December 31, 1944

Advances on consignments (90% of cost)	......	$ 2,515
Allowances on defective goods	$ 5,450	......
Bad debts written off	3,700	......
Bonding of employes—office	125	......
Bonds payable	......	20,000
Buildings	25,000	......
Capital stock	......	100,000
Cartage and express-in on purchases	1,875	......
Cash	22,500	......
Collection and exchange	350	......
Commissions and salaries—salesmen	22,150	......
Customers	125,000	......
Direct labor	155,000	......
Directors' fees	750	......
Discounts—general	......	2,250
Discounts—trade	2,015	3,150
Employers' liability	2,000	......
Expenses and commissions of buyers	2,500	......
Factory expenses	1,505	......
Freight-in on purchases	11,500	......
Freight-out on sales	5,500	......
Indirect labor	27,500	......
Insurance on factory (buildings, $150)	725	......
Interest expense	4,750	......
Inventory of merchandise 12/31/43	25,000	......
Inventory of raw materials 12/31/43	12,500	......
Land	15,000	......
Machinery and machine tools	20,000	......
Merchandise purchases	210,000	......
Merchandise sales	......	545,250
Notes payable	......	50,000
Notes receivable	750	......
Office furniture and fixtures	2,850	......

Office pay roll	9,000	......
Patents	12,500	......
Patterns (not used for process)	2,500	......
Power	10,500	......
Raw material storage	250	......
Repairs to factory (buildings, $475)	1,130	......
Reserve for amortization of patents	......	3,750
Reserve for bad debts	......	6,500
Reserve for depreciation of buildings	......	2,625
Reserve for depreciation of machinery	......	6,250
Reserve for depreciation of office furniture	......	1,250
Returned sales	20,500	......
Salaries of officers	7,500	......
Stationery, printing, postage	2,525	......
Surplus	......	19,510
Taxes (personal property, $500)	1,250	......
Telegraph and telephone	900	......
Tools—shop and hand	3,500	......
Trade creditors	......	21,500
Traveling expense—salesmen	6,500	......
	$784,550	$784,550

Supplementary Data

Amortization is to be at the rate of 6%.

Consignments have all been sold.

Commission on consignment is 5% on sales price of consignment (estimated on 10% profit on sales).

Depreciation of buildings is to be at the rate of 2.75%.

Depreciation of machinery and machine tools is to be at the rate of 10%.

Depreciation of office furniture and fixtures is to be at the rate of 10%.

Inventories, December 31, 1944:

Merchandise	$30,000
Patterns	2,000
Raw materials	15,000
Tools	2,750

One half of one per cent of net sales each year is charged to profit and loss and is credited to the reserve for bad debts.

The company treats its investment in land and buildings as a separate investment for which it expects to receive 5%.

Accruals and other possible adjustments are not to be considered.

THEORY OF ACCOUNTS

Thursday, May 17, 1945—9 a. m. to 12.30 p. m., only

Read and consider carefully each question before answering. Write your answer clearly and concisely, being particular to express your own knowledge, for on that is based the rating. If you wish, you may cite or quote authors in support of your answers. Designate each answer by number and check (√) number on question paper, but do not rewrite the question as part of your answer.

Do not sign your name to the paper. State your examination number.

Answer the questions as directed under each group. Papers entitled to 75 or more credits will be accepted.

Group I

Answer all questions in this group.

1 State *three* methods of accounting for the profits on sales made on an installment plan. What reserves should you provide in each instance?

2 Explain what is meant by *fixed* and by *variable* overhead cost for a manufacturing corporation. Give *three* examples of each type.

3 You have been engaged to install a complete accounting system for a manufacturing corporation of substantial size. Explain the essential features of the system you would recommend as applying to (*a*) cash, (*b*) pay rolls.

4 What is meant by *base stock* or *normal stock* inventory? Illustrate by examples the situations that may arise.

5 Name *three* accepted methods of computing depreciation. Explain briefly wherein they differ.

Group II

Answer five questions from this group. Indicate the questions answered by a check mark (√) placed at the left of number on question paper.

6 What are the distinctions between a profit and loss account and a surplus account? Give *three* examples of each classification.

7 Explain and compare the following terms: (*a*) replacements, (*b*) betterments, (c) renewals, (*d*) additions, (*e*) retirements. Which are capital charges and which expense charges?

8 Combinations of corporations may be effected by consolidation, merger and holding company. Differentiate the accounting treatment of these three methods of effecting combinations.

9 A company has insurd the life of its president for its own benefit and includes the amount of premiums paid as an asset in the balance sheet. Discuss the propriety of this treatment.

10 Explain the meaning in accounting of (*a*) cash basis, (*b*) accrual basis. Are those terms exact expressions or are they relative?

11 Is there any objection, practical or theoretical, to the practice of deducting cash disounts from invoices before taking them into the accounts? Give reasons for your answer.

12 When the Government renegotiates a contract with a corporation making sales to the public as well as to the Government, how are the proceeds of the following types of sales treated?

a Sale to a department store

b Sale to War Department

c Sale to an individual

d Sale to British Purchasing Commission

e Sale for lend lease

f 'War End' sale

g Sale to another corporation to be used by the second in the manufacture of some article for the Navy Department

h Sale to Maritime Commission

i Sale to a partnership manufacturing articles for both the Government and individuals

j Sale to Reconstruction Finance Corporation

PRACTICAL ACCOUNTING—Part II

Thursday, May 17, 1945—1.30 to 6 p. m., only

State your examination number on each sheet. Do not sign your name.

Consider carefully each requirement of each problem. Designate each solution by number. Consider technic and neatness as carefully as mathematics.

Answer the questions as directed under each group.

Group III

Answer one question from this group (30 credits). Indicate selection by a check mark (√) placed at the left of the number on the question paper.

5 Required: Computation of the inventory values, adjusting journal entries, work sheet, balance sheet and profit and loss statement.

The Frontier Lumber Company began business on January 1, 1944, with a capital of $1,500,000 representing cash received for 10,000 shares of preferred capital stock of $100 par and 100,000 shares of no-par-value common stock.

The timber tract and the necessary land, buildings and equipment were purchased. The tract is estimated to contain 400,000,000 board feet available for cutting. No depletion costs have been computed for the year 1944. Depreciation charges made by the company appear to be adequate.

An analysis of the Sales of Lumber account shows as follows:

		Thousand board ft	*Amount*
Grade A	$35	10,000	$350,000
Grade B	30	4,000	120,000
Grade C	20	4,000	80,000
Grade D	15	2,000	30,000
		20,000	$580,000

The production records of the company are as follows:

		Thousand board ft
Logs felled		24,000
Logs in pond		100
Inventory of finished lumber:		
Grade A	2,000	
Grade B	500	
Grade C	400	
Grade D	900	3,800

The corporation used 100,000 board feet of its Grade C lumber for the erection of a storehouse and made no entry therefor. You may disregard the depreciation on the storehouse for the current year.

The trial balance as at December 31, 1944, follows:

Cash in banks and on hand	$ 45,900	....
Accounts receivable—customers	75,650	....
Reserve for freight allowances	....	$ 4,300
Reserve for doubtful accounts	....	3,500
Standing timber—Tract 1	1,200,000	....
Material and stores inventory	7,500	....
Land	5,000	....
Buildings and structures	47,000	....
Machinery and equipment	140,000	....
Transportation equipment	75,000	....
Reserve for depreciation	....	28,710
Prepaid insurance and taxes	4,310	....
Accounts payable	....	16,400
Accrued wages	....	4,650
Capital stock	....	1,500,000
Sales of lumber	....	580,000
Logging operating costs	126,000	....
Loading operating costs	96,000	....
Mill operating costs	191,200	....
Shipping expenses	50,000	....
Selling expenses	45,500	....
General and administrative costs	28,500	....
	$2,137,560	$2,137,560

6 You have been engaged by The Appliance Manufacturing Corporation to prepare its financial statements for the year 1944.

The corporation manufactures an electric appliance that sells for $25 per unit. The transfers from factory to home office have been billed at an estimated cost of $22 per unit.

Trial Balance as at December 31, 1944

Cash	$ 10,500	....
Accounts receivable	40,500	....
Inventory finished goods Jan. 1, 1944 (1,500 units)	33,000	....
Finished goods transferred	693,000	....
Securities marketable	18,350	....
Patents	100,000	....
Land	50,000	....
Buildings	125,000	....
Equipment	225,000	....
Factory cost ledger	2,000	....
Selling expenses	40,000	....
General administrative expenses	70,000	....
Discounts on sales	10,500	....
Accounts payable	....	$ 35,500
Notes payable	....	45,000
Reserves for depreciation	....	61,250
Capital stock	....	450,000
Surplus earned	....	70,000
Sales (30,000 units)	....	750,000
Discounts on purchases	....	5,500
Interest received	....	600
	$1,417,850	$1,417,850

Factory Cost Ledger

Inventory raw materials, Jan. 1, 1944	$ 15,000	....
Inventory goods in process, Jan. 1, 1944	22,000	....
Raw materials purchased	220,000	....
Productive labor	260,500	....
Nonproductive labor	95,000	....
Insurance	6,250	....
Taxes	13,500	....
Heat, light and power	22,500	....
Repairs	18,000	....
Other manufacturing supplies and expenses	22,250	....
Finished goods transferred	....	$ 693,000
General ledger control	....	2,000
	$ 695,000	$ 695,000

Additional Data

Depreciation for the year 1944 not entered in accounts:

Building	2%
Equipment	5%

The patents are stated at cost and were acquired on January 1, 1939, and are considered to have an economic life of 10 years from the date of their acquisition.

The marketable securities, if sold, would realize $13,500.

Estimated loss on accounts receivable ½ of 1% of annual sales Accruals:

Insurance unexpired	$ 500
Miscellaneous taxes	750
Income and profits taxes	5,000
Selling expenses	600
Interest income	200
Interest expenses	700

Inventories, December 31, 1944:

Raw materials		$30,000
Goods in process:		
Materials	$25,000	.....
Labor	20,000	.....
Overhead	15,000	60,000
Finished goods 3000 units		

Group IV

Answer one question from this group (20 credits). Indicate selection by a check mark (√) placed at the left of the number on the question paper.

7 Required: Statement of assets and liabilities and statement of income and profit and loss for the year 1944.

The Professional Associates, Inc. has entered into a contract with the Federal Government to render a special type of professional service without profit. The contract specifies that the Government will pay only direct costs and that part of the overhead which is incidental to the services furnished. The work started in 1944 and will not be completed until the latter part of 1945, but bills are rendered monthly covering all direct costs plus 40% of the salary costs for overhead. Final settlement is to be made upon audit by the Government when the work is completed.

A trial balance of the accounts as at December 31, 1944 is as follows:

Cash	$ 5,600	......
Accounts receivable	35,400	......
Accounts receivable—Government	18,000	......
Furniture and fixtures	5,000	......
Prepaid expenses	1,800	......
Accounts payable	......	$ 15,000
Accrued expenses, taxes, etc.	......	4,000
Reserve for bad debts	......	1,500
Reserve for depreciation	......	2,000
Capital stock	......	20,000
Surplus	......	10,000
Revenues—regular	......	160,000
Revenues—Government contract	......	43,000
Salaries—regular	80,000	......
Salaries—Government contract	20,000	......
Outside costs—regular	10,000	......
Outside costs—Government contract	4,000	......
Supplies—regular	15,000	......
Supplies—Government contract	3,000	......
Travel—regular	20,000	......
Travel—Government contract	8,000	......
Promotional expenses	3,000	......
General and administrative expenses	23,000	......
Interest paid	1,200	......
Donations—American Red Cross	1,000	......
Provision for bad debts	1,500	......
	$255,500	$255,500

The general and administrative expenses are as follows:

Salaries of administrative officer, secretary, account clerks and telephone operators	$14,500
Telephone and telegraph	3,300
Stationery and office supplies	2,200
Audit fees	1,000
Trade dues and subscriptions	1,000
Research and experimental expenses	1,000
	$23,000

8 Prepare a schedule of selling price lines from the following data:

The Infants Wear Co. purchases piece goods in New York and ships them to contractors in Puerto Rico for manufacture into underwear for infants. The markers are made here and sent with the goods. Final pressing and examining are also done here but the other operations are performed in Puerto Rico.

THE OPA regulations limit the selling prices to a maximum of 162% of direct cost for sales made on terms of 8/10 E. O. M. and provide that this percentage must be adjusted correspondingly for sales made on any other terms. The Infants Wear Co. sells at 3/10 E. O. M.

The regulations further provide that direct cost includes only the cost of material, trimmings and direct labor, whether employed in the manufacturer's plant or in that of an outside contractor. For those having work done in Puerto Rico, it is provided that two thirds of the contractor's charges may be taken as direct labor and that 40% of the transportation and insurance costs may also be included in direct cost.

The manufacturer's pricing chart filed by the Infants Wear Co. shows that

they are entitled to the maximum price-cost ratio and their records disclose the following costs per dozen:

Category	Style	Material and trimming	Puerto Rico contractor	Freight and insurance	New York labor	Total
25	45/1	$5.96	$4.00	$.25	$.75	$10.96
	45/2	4.92	4.70	.25	.75	10.62
26	1002	3.96	3.39	.25	.70	8.30
	1003	2.40	3.50	.25	.70	6.85
101	595	1.04	2.20	.20	.50	3.94
	596	1.22	2.89	.20	.60	4.91

COMMERCIAL LAW

Friday, May 18, 1945—9 a. m. to 12.30 p. m., only

READ THESE INSTRUCTIONS BEFORE WRITING YOUR ANSWERS.

State your examination number on each sheet. Do not sign your name. Designate each answer by its number, in margin at left of ruling. Do not rewrite the question either wholly or partly in your answer. Consider each part of each question before you write your answer. Write legibly. State answers clearly, completely and concisely. File sheets of your answers in the serial order of the questions.

Answer the questions as directed under each group. Papers entitled to 75 or more credits will be accepted.

Group I

Answer all questions in this group.

1 *a* Fox, for value, gives a promissory note to Amos and Bell, partners, who indorse the note to Cody before maturity. Fox fails to pay the note at maturity and Cody, the holder, gives notice of dishonor to Amos only. The firm of Amos and Bell had been dissolved by mutual consent before maturity of the note, which fact the holder, Cody, knew and Amos had become financially irresponsible. The holder, Cody, seeks to recover from Bell, who disclaims liability for want of legal notice. Can Cody recover from Bell? Why?

b (1) What is a restrictive indorsement of a negotiable instrument?
(2) Is there more than one class or type of restrictive indorsement? If so, what are they?
(3) Does restrictive indorsement destroy the negotiability of the instrument?
(4) Give a common example of restrictive indorsement.
(5) What are the rights of an indorsee who receives a negotiable instrument with a restrictive indorsement?

2 *a* What are the general provisions of the Statute of Frauds as to a sale of personal property?

b When is a written memorandum necessary to take a sales contract out of the Statute of Frauds?

c What are the essential elements of such a memorandum?

d Must the memorandum be in (1) a special form or (2) a single writing?

e Aiken sold by sample 1000 bushels of wheat to Bowen and 1000 bushels to Clark, to be delivered at Aiken's warehouse. Bowen paid for his purchase, Clark did not. Aiken measured out the wheat, which conformed to the sample, put it into bags for delivery and awaited Bowen's and Clark's orders. Thereafter the warehouse and its contents, including the wheat in both parcels, were destroyed by fire

through no fault of either party. There was no insurance on the property and contents.

Aiken sues Clark for the price of the wheat sold him.

Bowen sues Aiken for the value of the wheat purchased by him.

What are the rights and liabilities of Aiken, Bowen and Clark, respectively? Explain fully.

3 *a* What sources may provide authority for cumulative voting of stockholders of business corporations?

b What is the purpose of cumulative voting and how does it operate?

c On the supposition that three directors are to be elected by two stockholders, of whom one, Abel, owns 70 shares and the other, Bach, owns 30 shares, illustrate how they could vote to get the best representation on the board of directors by (1) ordinary voting, (2) cumulative voting.

d May a director have another person attend directors' meetings and vote for him on his proxy? Explain.

e A corporation owns some of its own stock, which it carries in the name of the treasurer as trustee. May the treasurer vote the stock at an annual meeting of stockholders to elect directors?

4 *a* Aaron appointed Barrow, who was 17 years of age, his agent to buy certain goods. Barrow bought the goods but Aaron refused to take them, claiming that the contract was not good because of Barrow's infancy. Can Aaron be held on the contract Barrow made?

b Anderson owned land. He gave Barclay power under seal to sell and convey the land. Barclay sold it. In the body of the deed which he delivered, the grantor was named as "Barclay, agent of Anderson." The deed was subscribed "Barclay, agent of Anderson." In jurisdictions where land may be conveyed by an agent, did the deed pass legal title? What are the reasons?

c Carr Co. gave credit to Allison, who was really the agent of Brown. The agency was unknown at the time but it was discovered by Carr Co. after Brown failed. Could Allison, the agent, be held? Explain.

5 In federal gift-tax law, in effect in 1944,

a What is meant by the gift-tax exclusion? Who may avail himself of it and to what extent and how often? Are there any time limits? If so, what?

b What is meant by gift-tax specific exemption? Who may avail himself of it and to what extent and how often? Are there any time limits? If so, what?

c What is the basis used in computing a gift tax? Who pays the tax?

d What is the donee's basis for determining gain or loss on the sale of property acquired by gift?

Group II

Answer five questions from this group. Indicate the questions answered by a check mark (√) placed at the left of number on question paper.

6 *a* What *three* elements must be present in order to give rise to bailment?

b A warehouseman issued a uniform warehouse receipt, stating that the goods were to be delivered to John Jones or order or bearer, but added a provision that the receipt was nonnegotiable. Why? Was the receipt negotiable or nonnegotiable?

c Smith, a customer of a bank, left with the bank for safekeeping three negotiable bonds, the bank agreeing that it would keep them in its vault without charge. The bonds were placed in the vault, duly locked, but were later stolen by bank roberry. Smith sued the bank. Is the bank liable? Give reasons for your answer.

d Andrews stored goods in Burt's warehouse at the agreed price of $100 a month for storage charges. The goods were seized by a sheriff under an order by a court as the result of a judgment against Andrews. Burt immediately gave Andrews notice of the seizure, whereupon Andrews entered suit against Burt. Is Burt liable? Give reasons.

7 *a* What are *four* essential elements in the creation of a valid express trust of personal property?

b For a trust having real and personal property in several states, what law governs the validity of the purpose of

(1) A trust or real property?

(2) A testimentary trust of personal property?

c What disbursements should a trustee make (1) from income, (2) from principal, (3) to beneficiaries? Are there any exceptions as to (1), (2) or (3)?

d The trustee of an estate deposits $10,000 of the trust funds, together with $10,000 of his own money, in his personal bank checking account. The bank fails. No fraud is charged against the trustee. Nothing is realized from the bank on liquidation. Who sustains the loss? Is the trustee liable to the estate?

8 *a* Altman, Bowers and Cohen were partners in a firm selling merchandise. Cohen, personally, was adjudicated a bankrupt. What effect, if any, had this adjudication on the partnership?

b Ajax leased a farm to Billups and agreed to furnish Billups everything necessary to stock the farm. Billups agreed to cultivate the farm and furnish all the labor for one year, at the end of which Ajax and Billups were to divide the crop. Billups hired Cranstoun to aid him in carrying out the work at the farm. Cranstoun was not paid by Billups. Cranstoun sues Ajax for the value of his services, claiming Ajax and Billups were partners. Can he recover? Why?

c On the death of a partner, what are the rights of the personal representative of a deceased partner in the affairs of the partnership?

d The copartnership articles of Alden and Bruer stipulated that Alden should furnish all the capital and that Bruer should manage the business but without any liability for firm debts. Connors, knowing of these provisions, sold goods on credit to the firm.

(1) Who is liable, Alden, Bruer, or both Alden and Bruer?

(2) What would your answer be if the copartnership articles further stipulated that Bruer was a limited partner?

9 *a* Name and explain *five* essential elements of a valid contract, the absence of any one of which would render it void.

b (1) If an offer in contract is made by mail, when is the offer completed?

(2) If an acceptance in contract is made by mail, when is the acceptance completed?

(3) May either an offer or an acceptance be withdrawn? When?

c A written agreement for the sale of land was drawn by the proposed purchaser and sent to the landowner, who did not sign it but returned it with a letter signed by him, stating, "The inclosed agreement, of this date, is satisfactory. I will sell you the land described in it on the terms which are stated in it." The owner afterwards refuses to sell the land. Is this an enforceable contract? Explain your answer.

10 *a* What is a lease of real property and how is it created?

b Name and describe *five* principal provisions of a lease that are of importance to an accountant.

c Is an assignee or a sublessee of a lease bound by the terms and covenants of the original lease?

d As applied to real property, define license and easement and distinguish between them.

11 *a* In a surety contract for future obligations of the principal, what are the rights of a creditor, on the death of the surety,

(1) As to the estate of the surety?

(2) As to obligations incurred by the principal before and after notice to the creditor of the surety's death?

b Albert is surety for the partnership firm of Bixby and Cort on a bond to the extent of their purchases. Without Albert's knowledge, another partner, Dixon, was taken into the firm. Subsequently, Albert was sued on the bond with respect to a purchase made by the firm after Dixon had entered it. Is Albert liable? Why?

c Alec, an infant, enters Burton's employ, furnishing Burton his bond with Chase as surety for faithful performance of his duties. Alec defaults.

(1) Burton sues Alec, who pleads infancy. Can Burton recover from Alec? Explain.

(2) Burton sues Chase on the bond. Chase pleads Alec's infancy as a defense. Can Burton recover from Chase, the surety? Explain.

12 *a* Name and describe *four* types of claims against a bankrupt that are not discharged in bankruptcy.

b A person is insolvent but refuses to make an assignment for the benefit of creditors or to take any other action.

(1) In what way, if any, can his creditors bring about a distribution of his assets among them?.

(2) Is insolvency alone sufficient for this purpose?

(3) Can such proceedings be taken against all debtors? Are there any exceptions? If so, name them.

c The Amalgo company holds a note of the Crockett company for $2500. This note is secured by collateral worth $1800. The Crockett company goes into bankruptcy. The trustee expects to pay creditors 40 cents on the dollar. How much is this note held by the Amalgo company worth?

d Name and describe *three* differences between a dividend paid by a trustee in bankruptcy and an ordinary dividend paid by a corporation.

THEORY OF AUDITING

Friday, May 18, 1945—1.30 to 5 p. m., only

Read and consider carefully each question before answering. Write your answer clearly and concisely, being particular to express your own knowledge, for on that is based the rating. Avoid quotations from authors. Designate each answer by number and check (√) the number on the question paper, but do not rewrite the question as part of your answer.

Credit will be allowed not only for accuracy of answer but also for technic. Do not sign your name to the paper. State your examination number.

Answer the questions as directed under each group. Papers entitled to 75 or more credits will be accepted.

Group I

Answer all questions in this group.

1 *a* Explain *three* methods by which the sales records may have been falsified.

b Explain your audit procedure for disclosing such irregularities.

2 Outline the procedure that you consider adequate for auditing the inventories of raw materials and supplies kept by a manufacturing plant, when no physical inventory was taken at the close of the year you are auditing, but the stock ledgers were continually tested at low stock points throughout the year.

3 Should a certified public accountant regard the balance sheet as his representation concerning the financial condition of the company, or as the representation of the company itself, subject to his remarks in his report or certificate? Give reasons for your answer.

4 *a* In the course of a cash audit, to what records, other than the cash receipts and disbursements, is it necessary to refer?

b Mention the *four* general purposes that should guide the auditor in the substantiation of the cash records.

5 As an auditor, compare the following terms or distinguish between them: (*a*) internal check, (*b*) internal control, (*c*) internal auditing, (*d*) public auditing.

Group II

Answer five questions from this group. Indicate the questions answered by a check mark (√) placed at the left of number on question paper.

6 An importer signs "trust receipts" when the goods he imports are released to him. A bank, which has established commercial letters of credit in favor of the importer, engages you to audit the importer's accounts on its behalf.

In the course of this audit, would you investigate the importer's practice in paying the bank drafts drawn under the letters of credit? Explain your answer.

7 In reviewing the work of an accountant engaged upon the audit of a boat house, you are informed that the income has been verified as follows:

Daily cash receipts from the rental of boats by the hour or day have been verified by means of the appointment schedules kept by the dock attendant, independently of the bookkeeper or cashier. The other income consists of checks that are received monthly by mail for monthly rent, berth privileges etc. The daily recorded receipts have been reconciled with the deposits shown by the bank statements.

Do you consider that a satisfactory audit of the boat house income has been made? Explain your answer fully.

8 In your audit of a manufacturing corporation, you find an investment in machinery and equipment of $1,500,000, which represents the cost of original items plus additions, at cost, covering several years' expansion and growth.

During this period, the company has followed the policy of charging to the regular repairs expense account all items of a capital nature costing $100 or under. Repairs and maintenance charges have always been at levels sufficient to maintain the machinery and equipment in top operating condition.

Recently the Board of Directors passed a resolution, affecting your period, establishing the policy that 50 per cent of all repairs in the regular repairs expense account at the end of the year will be capitalized by journal entry. The reason for this procedure is that the directors believe cost figures are becoming prohibitively high because of depreciation and repair charges that they consider ultraconservative.

Your engagement calls for unqualified certified financial statements. As the auditor, explain fully how you would proceed under the conditions stated.

9 You have been engaged to audit the books of a corporation having a large research laboratory. The cost of this laboratory and its experiments amounts to several hundred thousand dollars annually. In accordance with established policy, this cost is charged to operations as development and research work etc. From time to time, new processes and patents result that produce new products or improved manufacturing technic in present operations. As the auditor, do you approve of continuing to charge the cost of this labratory to operating expense, or would you advocate capitalizing or deferring it? Explain fully.

10 In the audit of a large baking company, as of December 31, 1944, you find that it is customary to contract in July for a large supply of flour at a stated price. This supply is stored at the mill, shipped as ordered by the baking company and billed, when shipped, at the contract price. Shipment is made by the mill under negotiable bill of lading drawn to its order. A sight draft with bill of lading attached, drawn upon the baking company, is forwarded by the mill's bank for collection. Upon payment of the draft, the presenting bank indorses the bill of lading to the baking company.

You find that a carload of flour that had been ordered just prior to the close of the year is in transit at the close of the year under audit.

a Is there any liability to be shown in the balance sheet as of December 31, 1944? Explain fully.

b Should knowledge acquired after that date have any influence upon your report? Explain fully.

11 You have been engaged as the auditor of a general partnership and are preparing a report to be used for credit purposes. A very favorable financial condition is disclosed by your audit.

Through another professional engagement recently completed, you know that one of the general partners has a financial interest in another partnership whose affairs are in an unfavorable financial condition. Action by creditors would result in a forced sale that would wipe out the partnership capital and leave a deficit to be assumed by the individual partners.

As the auditor of the general partnership, should you give any consideration in your report or certificate to this involvement of one of the partners in another concern? Give full reasons for your answer.

12 *a* The 1944 Federal corporation income tax return, Form 1120, under the general caption "Deductions," has an item No. 27, Net Operating Loss Deductions.

b The 1944 Federal individual income tax return form Schedule D 1040, under the caption "Summary of Capital Gains and Losses," shows Column No. 2, Capital Loss Carry Over.

Give a brief explanation of the nature and function of items *a* and *b*, when applicable, and furnish examples.

STATE SOCIETY ACTIVITIES

Calendar of Events

June 21, Thursday—Regular meeting of the Board of Directors.

October 8, Monday—7:30 P. M. Regular meeting of the Society. Location: Waldorf-Astoria Hotel, Lexington Avenue and 49th Street, New York. Subject: To be announced.

October 8, Monday—Regular meeting of the Board of Directors.

Regional Conference Cancelled

Due to the ODT regulations, the Twelfth Annual Regional Chapter conference which had been scheduled for the Sagamore Hotel, Bolton Landing, Lake George, New York, on September 6th and 7th has had to be cancelled.

It is expected that a series of one day conferences in the four Chapter cities will be held some time in the latter part of September. Further details will be announced as soon as plans are completed.

Committee on Nominations

The following is the personnel of the 1945-1946 Committee on Nominations: Robert H. Montgomery, A. S. Fedde, P. W. R. Glover, Joseph Getz, Roy A. Wood, J. B. C. Woods, Freeman Davis.

The above members were elected at the May 14, 1945, meeting of the Society and two others will be selected by the Board of Directors at its October meeting.

Election of Officers

On May 14, 1945, the election of officers and directors of the Society for the forthcoming year was held at the Waldorf-Astoria Hotel. The Nominating Committee submitted the names of the following officers and directors for the ensuing year, who were subsequently elected to office. They will assume office on October 1, 1945.

Officers

William R. Donaldson....President
Prior Sinclair ....First Vice President
Percival F. Brundage.....Vice President
Simon Loeb ....Vice President
Henry E. Mendes........Vice President
Charles H. Towns........Vice President
Franklin C. Ellis..........Secretary
Harry E. Van Benschoten.Treasurer

Directors

(For a period of Three Years)

Henry A. Horne Edward A. Kracke

The meeting was addressed by Mr. Donaldson, First Vice President and President-Elect, whose address appears elsewhere in this issue. Mr. Samuel J. Broad, President of the American Institute of Accountants and member of the Society, presented an address which will be published in the July issue of this publication.

Election of Chapter Officers

At the annual Chapter meetings in May, the following men were elected to take office October 1, 1945.

Albany

Eugene J. Steiner ....President
Stanley A. Frederick......Vice President
William Boochever ......Treasurer
Sidney Urbach ....Secretary

Buffalo

Edward H. Hoch.........President
J. Ralph Toepfer.........Vice President
William P. Weyer........Treasurer
Edwin S. Phillips.........Secretary

Rochester

Robert T. Morrow........President
Rupert G. Fain...........Vice President
William D. Gasser........Treasurer
John A. May.............Secretary

Syracuse

Wendell N. Butler......... President
Allen C. Ritz.............Vice President
Charles R. Ernst.........Treasurer
Frederic S. Wilkinson.....Secretary

Members Change of Address

Attention is again called to the fact that members are requested to advise the office of their change of address, as no follow-up is made before the publication of the Society Year Book and Directory.

Jacob A. Falk, a member of the Society since April 12, 1929, passed away in January, 1945.

Word has just been received that Marcel Maurice Freeman, a member of the Society since January 8, 1941, passed away in October, 1944.

Glen Alan Butler, a member of the Society since November 10, 1938, passed away May 14, 1945.

George Greene, a member of the Society since September 17, 1942, passed away June 9, 1945.

The Society has suffered a great loss in the passing of these valued and esteemed members.

PROFESSIONAL COMMENT

SECURITIES AND EXCHANGE COMMISSION

Accounting Series—Release No. 52
May 10, 1945

The Securities and Exchange Commission today made public an opinion of its Chief Accountant in its Accounting Series discussing certain problems as to the presentation in financial statements of Federal income and excess profits taxes in cases where a company for which individual statements are filled pays its tax as a member of a consolidated group of companies. The opinion, prepared by William W. Werntz, Chief Accountant, follows:

"Inquiry has been made as to the method to be followed in reporting Federal income and excess profits taxes pursuant to the provisions of caption 15 of Rule 5-03 of Regulation S-X. In the case cited the company files for tax purposes as a member of a consolidated group but files with the Commission its individual financial statements. It is stated that on an individual basis the company would have been liable for $1,000,000 of Federal normal income and excess profits taxes; and that $400,000 of this amount represented excess profits taxes. As a member of a consolidated group its share of the consolidated income and excess profits taxes; and that $400,000 of this amount represented excess profits taxes. As a member of a consolidated group its share of the consolidated income and excess profit taxes was $700,000.

"Caption 15 of Rule 5-03 of Regulation S-X requires that there be stated separately '(a) Federal normal income and excess profits taxes; (b) other Federal income taxes; and (c) other income taxes."[1] Where a company is filing individual financial statements and reports on the same basis for tax purposes, the above breakdown of the total provision for Federal income and excess profits taxes should be made. Likewise, where consolidated financial statements are being filed, the above breakdown should be made.

"In the case cited, however, the provision made by the individual reporting company for income and excess profits taxes represents merely a provision for its share of the income and excess profits taxes of the consolidated group of companies. In the instant case, the share of the aggregate consolidated tax apportioned to an individual member of the group was, I understand, determined on the basis of the ratio of the total tax that would have been paid by a particular company to the combined tax that would have been paid had all members of the group filed on an individual basis. Under such circumstances, I am of the opinion that an allocation of an individual company's share of the aggregate tax as between excess profits taxes on the one hand and normal and surtax on the other hand would be arbitrary and of little significance. For this reason I feel it would be appropriate for a member of the group to combine in its individual statements subdivisions (a) and (b) of caption 15 and to show its provision for Federal income and excess profits taxes as a single item. By means of footnotes, however, there should be shown the estimated amount of Federal income and excess profits taxes applicable to the company had it filed on an individual basis, with an indication of the estimated amount of excess profits taxes involved."

[1] In Accounting Series Release No. 23 (April 9, 1941) it was indicated that caption 15 contemplated "that the normal income, defense, and declared value excess profits taxes should be included under subsection (a) and the excess profits tax prescribed by the Second Revenue Act of 1940 should be included under subsection (b)." The excess profits taxes presently in effect should therefore be shown under (b).

Book Notes

HOW TO SPEED UP SETTLEMENT OF YOUR TERMINATED WAR CONTRACT

By J. K. LASSER

McGraw-Hill Book Company, Inc., Publishers, 1945
186 pages, $3.50

This book gives American businessmen a simple, untechnical explanation of the way in which they can handle their plant operations, inventories, and settlements before and after they receive a termination notice. Mr. Lasser's clear, authoritative, and timely advice will be helpful to executives, lawyers, public accountants and others. The book contains a complete statement of all of the law, rules, regulations, forms, reports, and other Government data issued to this date on the subject of termination. Much of it has been boiled down into a series of check lists that tell the large and small contractor how to proceed and how to get maximum protection in his dealings wih Government officials.

NEW YORK LAWS AFFECTING BUSINESS CORPORATIONS

(ANNOTATED)

United States Corporation Company, 1945
602 pages, $2.00

This is the twenty-sixth edition of this work, revised to April 24, 1945, and includes changes in pertinent sections of the Tax Law, emanating from the 1945 session of the New York State Legislature. Besides the statutes, it includes liberal annotations of judicial decisions in the form of abstracts, in the court's exact language, with numerous citations of supporting cases.

COST ACCOUNTING BIBLIOGRAPHY

By A. L. PRICKETT

The School of Business, Indiana University, 1945

470 pages, $1.00

No bibliography of cost accounting publications of a fairly extensive nature has been available. This study includes publications from 1890 to July, 1944. It is not an all inclusive bibliography but is limited to the bibliographical sources in the field of accounting that are available. It is divided into eighteen classifications as follows:

1. Materials and Inventories
2. Labor
3. Overhead
4. Selling and Distribution Expenses
5. Job Order Costs
6. Standard Costs
7. Statements and Reports, Use of Cost Data, etc.
8. Taxes
9. Waste and Spoilage, Scrap
10. Process Costs
11. Budgets
12. Governmental Accounting and Institutional Accounting
13. Joint and By-Product Costs
14. Industries and Groups (Trade Associations)
15. Fixed Assets (Depreciation)
16. General
17. Problems
18. Costs and the War